cutting through complexity

TAX

A Guide to UK Oil and Gas Taxation

2012 edition

kpmg.co.uk

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About this book

This book is a general guide to UK oil and gas taxation as it affects producers, ancillary operators (broadly, contractors) and employees. The book sets out the law in force, announced legislation and practice prevailing at 30 November 2012. It is designed to bring out the main features of the regime, to provide broad practical guidance and to identify some of the problems likely to be encountered. It is not intended, however, to be comprehensive or to provide answers to particular problems and should not be regarded as a substitute for professional advice.

Further professional advice on specific matters may be obtained from KPMG: Appendix V gives the addresses and telephone and fax numbers of our UK offices.

KPMG LLP (UK)
December 2012

Foreword

Welcome to the 2012 edition of the KPMG Guide to UK Oil and Gas Taxation.

The two years since the last edition of the Guide has, as expected, seen considerable amendments to the UK upstream taxation system. With the increase in SCT rate to 32%, the decommissioning relief restriction and new and extended field allowances there have been significant changes.

The next two years will similarly see many changes with the most significant being the potential introduction of Decommissioning Relief Deeds. Providing certainty to tax relief on decommissioning and the consequent implications for financing would be a huge step forward and would go some way to alleviating the lack of certainty that has become the norm in the UK upstream taxation system over the last decade. This edition of the Guide is published during the Consultation period and therefore we have decided not to include commentary at this stage. We hope that our next edition includes the new rules and that the work and effort put in by Government and Industry leads to an effective arrangement.

Whether you are new to the Industry looking for an easy to read guide or have been working in the Industry for a while and are just looking for the new statutory references we hope you find this edition of our Guide of use.

Andrew Lister
KPMG LLP

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Abbreviations

ACT - Advance corporation tax

APRT - Advance petroleum revenue tax

BFO - Brent – Forties - Oseberg

BFOE - Brent – Forties – Oseberg - Ekofisk

CAA - Capital Allowances Act

CCL - Climate change levy

CCS - Carbon Capture and Storage

CT - Corporation tax

CTA - Corporation Tax Act

DCPD - Decommissioning Cost Provision Deeds

DECC - Department of Energy and Climate Change

DTI - Department of Trade and Industry

E&A - Exploration and appraisal

EC - European Community

EEA - European Economic Area

EES - Exploration Expenditure Supplement

EU - European Union

FA - Finance Act

HMRC - Her Majesty's Revenue and Customs

IBA - Industrial Building Allowances

ICTA - Income and Corporation Taxes Act

IPT - Insurance premium tax

ITEPA - Income Tax (Earnings and Pensions) Act

LPG - Liquid Petroleum Gas

MEA - Mineral extraction allowance

MOE - Month of Entitlement

MSC - Managed Service Company

NIC - National Insurance Contribution

OECD - Organisation for Economic Co-operation and Development

OP - Old Participator

OTA - Oil Taxation Act

PAYE - Pay As You Earn

PRT - Petroleum revenue tax

PRTA - Petroleum Revenue Tax Act

R&D - Research and development

R&DA - Research and development allowance

RFES - Ring Fence Expenditure Supplement

SAO - Senior Accounting Officer

SCT - Supplementary charge to corporation tax

SI - Statutory Instrument

SME - Small or Medium Enterprises

SP - Statement of practice

SPD - Supplementary petroleum duty

SSCBA - Social Security Contributions & Benefits Act

TCGA - Taxation of Chargeable Gains Act

TIOPA - Taxation (International and Other Provisions) Act

TETR - Tax-exempt tariffing receipts

UKCS - UK Continental Shelf

UKOITC - UK Oil Industry Taxation Committee

VAT - Value Added Tax

References

Marginal and other statutory references are to the Oil Taxation Act 1975 unless otherwise stated.

References to 'oil' include natural gas, except where the context requires otherwise.

'UK' means the United Kingdom itself and offshore areas up to the 12-mile limit of the territorial sea.

Areas of the European Continental Shelf in which the UK exercises rights over the natural resources of the sea bed and the subsoil are referred to as 'designated areas' or 'Continental Shelf'.

Part 1 Introduction

Chapter 1

Summary of UK tax regime

Oil producers

1.1 A producer of oil in the UK or from the UK Continental Shelf (UKCS) will be subject to corporation tax (CT) and supplementary charge to corporation tax (SCT – sometimes referred to as the supplementary charge), currently at 30 percent and 32 percent respectively for the financial year to 31 March 2013. In addition, and depending on the date on which the government gave its consent to the development of the producing field, he may be subject to petroleum revenue tax (PRT), at 50 percent. The government take varies depending on the interaction of the taxes and the differing methods of computation for each tax. By way of illustration, it may be seen that the effective rate of taxation on marginal income in the year ending 31 March 2013 is as follows:

	Field chargeable to PRT	PRT/ royalty free field
Production value	£100.00	£100.00
PRT at 50%	50.00	–
	50.00	100.00
CT at 30%	15.00	30.00
SCT at 32%	16.00	32.00
Net after taxes	19.00	38.00
Total taxes	81.00%	62.00%

PRT is deductible in arriving at profits for CT.

A UK oil producing company with non-ring fence profits (see Chapter 11) will be subject to a CT rate of 24 percent on those profits (as noted above, the 30 percent rate applies to its ring fence profits).

Other companies

1.2 Companies which are not oil producers are subject only to CT and not to PRT or SCT. Their normal rate of taxation is 24 percent from 1 April 2012 (or 20 percent for companies with a small level of profits) for the financial year to March 2011 although the incidence of capital allowances and other reliefs may vary the effective rate. The CT rate applicable to non-ring fence profits will reduce to 23% from 1 April 2013 and is expected to fall to 22% from 1 April 2014.

Individuals

1.3 Individuals are currently subject to income tax at two rates. For the year to 5 April 2012, the basic rate is 20 percent and applies to taxable income up to £34,370 per annum. Income above £34,370 per annum is taxed at a single higher rate of 40 percent. Income above £150,000 per annum is taxed at a rate of 50 percent in the year to 5 April 2012.

HM Revenue & Customs (HMRC)

1.4 HMRC, Large Business Service Oil, Gas and Mining, Bush House, South West Wing, Strand, London WC2B 4RD generally deals with:

- PRT;
- CT and SCT on:
  - UK oil production;
  - non-resident contractors;
  - income of UK taxpayers from oil production abroad;
  - certain service and other companies engaged in functions related to the oil industry.

1.5 Some smaller upstream companies and service companies in the oil business continue to be dealt with by Inspectors of Taxes in the ordinary local HMRC districts with also some oil company's tax affairs being dealt with by Scotland West in Glasgow.

1.6 UK-based individuals engaged in the oil industry are generally dealt with by their local Inspectors of Taxes. HMRC Special Compliance Offices deal with cases where offshore employees do not appear to have met their liabilities, either directly or by deduction by their employers at source under the Pay As You Earn (PAYE) scheme.

Other taxes

Value added tax

1.7 Value Added Tax (VAT) applies to goods and services supplied in the UK or its territorial sea (which extends 12 nautical miles from the UK coastline). Imports of goods into the UK are typically subject to import VAT and UK VAT is normally chargeable on supplies of goods made within the UK. However a number of oil products may be stored in the EU under excise duty suspension. Supplies in the UK under excise suspension also have VAT suspended. Exports of oil goods from the UK to a non-EU destination are zero-rated for VAT purposes. UK VAT is not due on movements of oil products to other EU member states as long as your customer is VAT registered in an EU member state other than the country from which the goods are dispatched. However, businesses who supply goods from the UK to other EU member states are likely to have a requirement to submit monthly EC sales list and Intrastat dispatch supplementary declarations. Businesses who purchase oil products from other EU member states are required to account for acquisition tax on arrival of the goods in the UK and are likely to have a requirement to submit monthly Intrastat arrivals declarations. Special rules apply to the supply of natural gas where your customer is a dealer in natural gas (i.e. their primary purpose in purchasing the gas, is the resale of the product rather than its consumption). Under these special rules VAT is not charged on supplies where your customer is located outside the EU, or is established in an EU member state other than the UK and supplies a VAT registration number from that country.

With effect from 1 January 2010 the basic place of supply rule for business to business transactions is where the customer belongs. There are some exceptions to the basic rule including services relating to land (taxed where the land belongs), cultural, educational, entertainment and catering services (taxed where physically carried out) passenger transport (taxed where the transportation takes place) and hiring of means of transport (taxed where the hire vehicle is made available to the customer). Supplies of services falling under the basic rule made to EU customers (i.e. where the customer has to account for VAT under the reverse charge) must, with effect from 1 January 2010, be declared on the monthly EC sales lists. Where a business receives services from a non UK business which fall under the basic rule, the business must self-account for UK VAT under the reverse charge mechanism.

1.8 HMRC have agreed with UKOITC a memorandum of understanding in respect of exploration and production in the North Sea. This memorandum details and confirms the VAT treatment of supplies of goods and services supplied/received by oil companies within the UK and UKCS (it should be noted that this agreement requires updating in respect of services supplied after 2010).

Import duties

1.9 Import duties apply to goods imported into the UK from outside the EU in connection with the oil industry in the normal way. There may be relief from duty under relief for temporary importation, End Use relief (Continental Shelf relief for goods used to construct, repair, maintain or fit out offshore platforms) or for goods processed under customs control.

Uniform business rate

1.10 The uniform business rate is a local property tax on non-domestic properties and came into force on 1 April 1990. It is based upon a multiple, determined by the government, of the rental value of each property. The rental values are reassessed every 5 years, at present, with the last revaluation brought in force on 1 April 2010.

Excise duty

1.11 Excise duties are due on most hydrocarbon oils used for fuel and power in the UK. More recently has seen the introduction of bio fuels that are still liable to excise duty albeit until 1 April 2010 at rates lower than normal hydrocarbon oils. From 1 April 2010 bio fuels will be taxed at the same rate as the main road fuels with the exception of bio-diesel manufactured from waste cooking oil which will maintain its lower rate of duty for an additional 2 years. The rate of duty chargeable depends on the type of product concern. In general, the payment of duty can be deferred by storing the products in an excise suspended location, such as at refinery premises or other locations approved by HM Revenue & Customs.

Stamp duty and capital duty

1.12 Broadly, stamp duty now only applies to the transfer of UK shares at a rate of 0.5 percent. Stamp duty land tax applies to transactions which transfer interests and rights in and over land in the UK. UK is defined for these purposes to include all land up to the low water mark and hence excludes offshore oil licences.

Rate	Non-residential	Residential
Zero	£0 – £150,000	£0 – £125,000
1%	Over £150,000 – £250,000	Over £125,000 – £250,000
3%	Over £250,000 – £500,000	Over £250,000 – £500,000
4%	Over £500,000	Over £500,000 – £1 million
5%	-	Over £1 million – £2 million
7%	-	Over £2 million

The 7% rate applies to transactions in residential property from 22 March 2012. A 15% rate applies to purchases from 21 March 2012 by certain "non-natural" persons. This broadly includes bodies corporate, such as companies, collective investment schemes and all partnerships with one or more members who are either a body corporate or a collective investment scheme.

1.13 Capital duty was abolished with effect from 15 March 1988.

Insurance premium tax

1.14 Insurance premium tax (IPT) is a tax for certain UK insurances. The standard rate of IPT is currently 5 percent of the gross premium with a selective higher rate also in existence (increasing to 6 percent from 4 January 2011). Re insurance, long-term risks (e.g., life assurance) and goods in foreign international transit are some specific insurance types that are currently exempt from UK IPT. The tax can significantly increase insurance costs for many companies in the oil industry, given their large insurance portfolios. However, many of the industry's insurance risks (e.g., fixed pipelines), may be partly or wholly outside the UK's 12-mile territorial limits and hence partly or fully exempt from UK IPT. There may, however, be overseas premium taxes or other statutory levies (commonly described as parafiscal taxes) due, which can be significantly higher than for UK risks.

Climate Change Levy

1.15 The Climate Change Levy (CCL) was introduced on 1 April 2001 and is part of a range of measures designed to help the UK meet its commitment to reduce greenhouse gas emissions. It is a tax chargeable on the business consumption of gas, electricity, LPG and solid fuel. The levy does not apply to taxable commodities used by domestic consumers, or by charities for non-business purposes.

1.16 Businesses covered by Climate Change Agreements are relieved from the full amount of the levy.

1.17 The levy does not apply to oil products or to otherwise taxable commodities used for transport purposes.

Emissions trading

1.18 The UK Emissions Trading Scheme was introduced in 2002 with the intent to reduce greenhouse gas emissions by incentivising emission reductions where the cost of the reduction is lowest, therefore lowering the overall costs of combating climate change.

1.19 This measure effectively allows the Government to regulate the amount of emissions produced in aggregate by setting the overall cap for the scheme but provides flexibility in determining how and where the emissions reductions will be achieved.

1.20 Participating companies are allocated allowances. Each unit of allowance represents a tonne of the relevant emission. Emissions trading allows companies to emit in excess of their allocation of allowances by purchasing allowances from the market. Similarly, a company that emits less than its allocation of allowances can sell its surplus allowances providing a cash incentive for reducing emissions. There are penalties if emissions entitlements are exceeded.

1.21 The EU Emissions Trading Scheme was introduced on 1 January 2005. The EU-wide emissions trading scheme allows UK participants to buy and sell carbon emission allowances across Europe with the aim of reducing emissions, in line with international and domestic targets, and taking account of business competitiveness issues. At the time of writing, we are in Phase II of the scheme.

1.22 After discussions between HMRC and industry, the following broad tax treatment in relation to Phases I and II of the scheme has been agreed:

- For PRT purposes, costs associated with the purchase of allowances to meet any shortfall are deductible, whilst the sale of any surplus amounts is not subject to PRT.
- For CT/SCT purposes, costs associated with the purchase or trading of allowances used in relation to ring fence installations qualify as ring fence deductions (see Chapter 11). Proceeds from the sale of such allowances constitutes ring fence income.

The position in relation to penalties (ie if allowances are less than emissions) has not been agreed but HMRC consider they are not deductible for CT/SCT or PRT purposes. The position in relation to non-EU scheme allowances/credits is outside the scope of this book.

Exchange control

1.23 There are currently no exchange controls in the UK, and the 1947 Exchange Control Act has been repealed. Prior to their suspension in 1979 the controls never sought to restrict remittances of after tax profits from the UK by overseas-based investors.

EU Taxation

1.24 The growing influence of the EU on UK taxation is a developing theme. It is beyond the scope of this book to deal with its potential effects on UK oil taxation.

Part 2 Petroleum Revenue Tax

Chapter 2

General scheme of petroleum revenue tax

Non-taxable fields

2.1 FA 1993 introduced the concept of taxable and non-taxable fields, abolishing petroleum revenue tax (PRT) for the latter.

2.2 A non-taxable field is an oil field:

(a) for no part of which development consent was granted before 16 March 1993; or

(b) for no part of which a development programme was served on the licensee or approved by the Secretary of State before 16 March 1993.

2.3 From 1 July 2007 a previously abandoned taxable field (a UK recommissioned field) will also be non-taxable if:

(a) an abandonment programme for all relevant field assets has been approved by the Secretary of State;

(b) the programme has been carried out to his satisfaction; and

(c) a (new) development decision is made, after the programme has been carried out, on or after 16 March 1993.

2.4 From 1 July 2008 the responsible person for a taxable field may, with the agreement of all participators, make an irrevocable election that the field be non-taxable. The Commissioners of HMRC must decide whether the field is non-taxable. They will do so if it appears to them that either:

(a) no assessable profit will accrue to any participator in future (Condition A); or

(b) any such assessable profit will be fully covered by oil allowance (Condition B).

The Commissioners may cancel their decision (with effect ab initio) that a field is non-taxable within 3 years if it appears to them that their decision was based on inaccurate or incomplete information. No unrelievable loss may accrue from a non-taxable field.

2.5 Where a field is non-taxable it is entirely outside the charge to PRT on any of its profits or receipts. Equally, it is not capable of generating any PRT losses or reliefs (Paragraphs 6.7 and 6.11) for use against the PRT profits of a taxable field. Certain aspects of the PRT regime, however, will still impact on non-taxable fields. For example, expenditure (Chapters 5 and 6) may need to be apportioned between taxable and non-taxable fields and therefore PRT-relevant records may be required in respect of non-taxable fields as well as taxable fields. Similarly, for CT purposes, the valuation of production from non-taxable fields will continue to be established in accordance with PRT rules (Paragraph 11.48).

Taxable fields

2.6 For taxable fields, PRT applies to the profits (as specially computed) from oil and gas production in the UK and UK-designated areas of the Continental Shelf. It also applies to certain tariff and disposal receipts of taxable fields, but does not otherwise apply to the profits of ancillary operations. The tax is a prior charge to CT.

2.7 PRT is chargeable on the basis of the results of successive chargeable periods of six calendar months ending on 30 June and 31 December. CT accounting periods and the date to which a company makes up its accounts have no relevance.[1]

2.8 The rates of PRT have been:

13 November 1974 to 31 December 1978	45%
1 January 1979 to 31 December 1979	60%
1 January 1980 to 31 December 1982	70%
1 January 1983 to 30 June 1993	75%
1 July 1993 onwards	50%

2.9 PRT is levied on participators, which normally means licence holders, on a field-by-field basis. Generally, expenditure relating to one field may not be offset against profits arising on another. However, special reliefs (Chapter 6) may be available in respect of the following types of expenditure incurred in or in relation to the UK or the UK Continental Shelf:

[1] In addition to the above, advance petroleum revenue tax (APRT) was payable for periods beginning on or after 1 January 1983 and ending on or before 31 December 1986. APRT had replaced supplementary petroleum duty (SPD) which applied for two years to 31 December 1982. Neither has much continuing relevance.

- abortive exploration expenditure incurred on or after 1 January 1960 and before 16 March 1983;
- onshore exploration and appraisal (E&A) expenditure incurred after 15 March 1983 and before 1 April 1986;
- offshore E&A expenditure incurred after 15 March 1983 and before 16 March 1993 (or, in certain restricted circumstances, before 16 March 1995);
- certain oil-related research expenditure incurred after 16 March 1987 not related to a specific field;
- up to 10 percent of certain development expenditure incurred after 16 March 1987 on taxable offshore fields outside the southern basin of the North Sea which first received development consent after that date;
- unrelieved losses from a taxable field which is permanently closed down.

2.10 In arriving at assessable profits for PRT, no distinction is made between capital and revenue expenditure, and both may be allowed as they are incurred. PRT does not therefore normally become payable for any field until payback on the investment has been reached. Where a participator elects, development expenditure may be spread forward over a number of chargeable periods up to ten years in computing PRT.

2.11 Subject to specific exclusions, CT allows for the deduction of all expenditure incurred wholly and exclusively for business purposes. By contrast, PRT only permits the deduction of specified expenditure. The principal non-deductible item is interest, but to compensate for this an uplift of 35 percent is applied to certain categories of expenditure. Uplift is not given for expenditure under certain contracts lasting more than nine months unless stage payments are adequate in frequency and amount. Uplift is not given for expenditure incurred after a field has reached payback.

2.12 For fields which received development consent prior to 1 April 1982, an oil allowance equal to the value of 250,000 metric tonnes of oil per field per chargeable period is given, subject to an overall limit for each field of 5m metric tonnes. For fields given development consent after 31 March 1982, these figures are increased or reduced depending on the location of the field:

(a) for offshore fields outside the southern basin of the North Sea, they are increased to 500,000 and 10m tonnes respectively;

(a) for southern basin or onshore fields, they are reduced to 125,000 and 2.5m metric tonnes.

2.13 There is also a limit to PRT payable known as 'safeguard' which limits the PRT for a chargeable period to 80 percent of the amount by which the revenue profits exceed 15 percent of the accumulated capital expenditure to the end of that period. This relief is only available for half as many chargeable periods again as are required to reach payback as defined for uplift.

2.14 The effect of the field-by-field basis can be very significant in project planning. There may, for example, be a doubt as to whether a new development constitutes a new field or an extension of an existing one. If it is a new field, given development consent after 15 March 1993, it will be non-taxable; if it is an extension to an existing, taxable field, then it will fall within the charge to PRT.

2.15 The arrangements for the assessment and payment of PRT are complex. Instalments of PRT are payable monthly from the end of the second month of each chargeable period of six months. Any balance due or repayable is adjusted at the end of the second month after each chargeable period.

2.16 Interest on underpaid instalments of PRT runs from the due date of each payment. Interest on the balance of the PRT liability runs from two months after the end of each chargeable period. If the balance of the liability is overpaid, interest is also due to the taxpayer on a similar basis.

2.17 There are complex return and administrative procedures with which the taxpayer must comply and which require considerable management effort.

2.18 Special transactions are dealt with in Chapter 16.

2.19 It should be noted that whilst, in recent years, there has been much consultation and discussion on the future of the PRT regime (including whether it should be abolished, a PRT buy-out scheme introduced etc) no conclusion has yet been reached.

Chapter 3

The charge to PRT

3.1 PRT is charged on profits from oil won from taxable fields in the UK and the UKCS. It is assessed on each participator in each oil field on the basis of successive six-monthly chargeable periods. PRT is also charged on certain tariff and disposal receipts derived from the assets of taxable fields.

Section 1(1), (2) & (3)

Oil

3.2 Oil includes natural gas. However, gas sold to British Gas under a contract made before 30 June 1975 is disregarded. This had the effect of exempting from PRT the profits of those southern gas fields where the prices achieved did not reflect the subsequent escalation of world oil prices. There is a de minimis provision whereby associated oil is also excluded provided it is cumulatively not more than 5 percent by quantity of the participator's share of production from the field. The related expenditure and other debits and credits are also excluded or, where a field is only partly excluded, apportioned. Gas disregarded under these provisions is known as 'exempt gas'.

Sections 1(1) & 10

3.3 This exemption also applies to situations where a gas sale contract made with British Gas Corporation (or one if its successor companies i.e., British Gas plc, now BG Group plc, and British Gas Trading Limited, which is currently owned by Centrica plc), before the end of June 1975, is replaced by a new contract at any time after June 1975 and any of the rights and liabilities of the seller under the original contract are transferred to another person under a new contract. The issue of amendments to pre-30 June 1975 contracts was considered in Shell UK Ltd -v- RCC [2007] SpC 624, whereby it was decided that the amended/new contract did not result in exempt gas.

Section 94 FA 99

Oil field

3.4 Oil fields are determined by notice given by the Secretary of State for DECC. Fields are given a name and a number. He must give written notice of the proposed determination to all licensees affected and must consider any written representations which they may make within 60 days of receiving the notice. He is not obliged to act on these, nor is there any appeal

from his decision. Assurances were given whilst OTA 1975 was passing through Parliament that fields will be determined by reference to geological considerations alone. Determinations may be varied by following similar procedures to the original notification. Provision is made to protect the charge to tax in circumstances where production commences before a determination is made. In such cases, or where an oil field is varied, administrative and payment requirements are modified so that action is related to the actual date of determination or variation.

3.5 Oil fields will continue to be determined in this way even if they are non-taxable; non-taxable fields remain 'oil fields' for the purposes of the oil tax legislation.

Para. 6 Sch. 1

3.6 Areas which have closed down will continue to be treated as oil fields until the completion of the decommissioning or (perhaps exceptionally) becoming part of another oil field.

Participator

Sch. 1
Section 12(1)
Para. 5 Sch. 3

3.7 Participators are normally licensees or sub-licensees. Where an illustrative agreement (Paragraph 16.1) applies, the holder of the benefit of the illustrative agreement is regarded as a participator, provided that both companies who are party to the agreement are under common control or one controls the other.

Para. 6 Sch. 3

3.8 In some cases the participator may not be the economic owner of a proportion of his share of the oil. This might well arise under the terms of certain financing arrangements where the lender is to receive a proportion of production by way of repayment. In such a case the participator remains chargeable to PRT and is treated as having disposed of the oil otherwise than at arm's length. If the economic owner has disposed of oil at arm's length, the participator may elect to have this price substituted.

3.9 The above provision has not been entirely successful in determining where the burden of PRT should lie, since it does not apply where the economic owner is also a participator in the field. In cases which are not straightforward, such as farm-outs, it can be difficult to decide to whom the oil accrues for PRT purposes.

3.10 The original definition of participator was quite narrow, with the purpose of avoiding the proliferation of persons upon whom PRT would be charged. The enormously complex provisions, for example in relation to transfer of interests in fields, and more recently in the improvement of abandonment reliefs required considerable tinkering in that definition, most recently in FA 2009, which has unbalanced the concept of "former oil fields" and "former licences".

Chargeable period

3.11 Chargeable periods are half years ending on 30 June and 31 December. The first chargeable period for any taxable field includes an unlimited time prior to the beginning of that half year. The first chargeable period ends at the end of the half year in which the cumulative total of oil won and saved from the field equals 1,000 metric tonnes. 1,100 cubic metres of gas at a temperature of 15°C and a pressure of one atmosphere is regarded as equivalent to one metric tonne of oil

Section 1(3) & (4)

Profits chargeable to PRT and payment

3.12 PRT is presently charged at 50 percent on the assessable profits (Chapter 4) of each participator as reduced by allowable losses (Chapter 4) and the participator's share of the cash equivalent of the oil allowance (Chapter 7). In addition there is a limit, known as safeguard (Chapter 8), on the amount of PRT payable. PRT liabilities are satisfied by monthly instalments and a further payment on account which is made two months after the end of the chargeable period (Chapter 9). When PRT is finally assessed any balance is either payable or repayable. The computation and payment of PRT may be illustrated as shown below:

	£	
Assessable profits	A	Section 2
Less allowable losses brought forward or carried back	(B)	Section 7
	C	
Less cash equivalent of oil allowance	(D)	Section 8
Chargeable profit	E	
PRT payable at 50%	***†F**	

* This may be limited to a lower figure by safeguard.

† Satisfied by payment on account two months after end of chargeable period to the extent not met by earlier instalments (Paragraph 9.7).

Section 9

Section 1 PRTA 80

Chapter 4

Assessable profits and allowable losses

Section 2(2)

4.1 It is in computing assessable profits and allowable losses that the greatest contrast with CT arises. Financial statements are completely ignored and instead the profit or loss for each taxable field in which a participator has an interest is arrived at by aggregating positive amounts and negative amounts. If the result is positive, an assessable profit arises; if negative, an allowable loss arises. The computation may be illustrated as follows:

Section 2(3)(a)

Section 118 FA 81

Sections 6 & 7 OTA 83

Section 2(3)(b) & Section 118 FA 81

Assessable profit or allowable loss	Para	£	£
Positive amounts:			
Gross profit	4.2	A	
Licence credit	4.58	B	
Licence payment other than royalty	4.60	C	
Credit re expenditure	4.62	D	
Tariff receipts (net of TRA)	4.34	E	
Asset disposal receipts	4.54	F	G
Negative amounts:			
Gross loss	4.2	(H)	
Licence debit	4.58	(I)	
Licence payment other than royalty	4.60	(J)	
Debit re expenditure	4.62	(K)	
			(L)
Assessable profit or allowable loss			M

Gross profit or loss

4.2 Gross profit or loss is broadly equivalent to the value of production in the chargeable period. The computation may be illustrated as follows:

	Para		£	
Deliveries of oil at arm's length	4.3	sale proceeds	A	Section 2(5)(a)
Deliveries of oil otherwise than at arm's length	4.9	aggregate market value	B	Section 2(5)(b)
Relevant appropriations	4.23	aggregate market value	C	Section 2(5)(c)
Closing stocks	4.26	one-half market value	D	Section 2(5)(d)
Excess of nominated proceeds	4.29	excess amount	E	Section 2(5)(e)
			F	
Less opening stocks	4.26	one-half market value	(G)	Section 2(4)(b) Para. 1 Sch. 3
Gross profit or loss			H	

Deliveries of oil at arm's length

4.3 This item consists of oil disposed of crude in sales at arm's length and delivered in the chargeable period.

Section 2(5)(a), Para. 4 Sch. 3

4.4 The meaning of the term 'sale of oil at arm's length' is very restricted. A sale qualifies only where:

Para. 1 Sch. 3

(a) the contract price is the sole consideration for the sale;

(b) the terms of the sale are not affected by any other commercial relationship between the parties or any person connected with the parties to the contract;

(c) neither the seller nor a connected person has any interest, direct or indirect, in the subsequent resale or disposal of the oil or of any product derived therefrom.

4.5 The onus is on the company to show, effectively, that the transaction is a straightforward arm's length sale. If a sale does not meet all the above conditions, it is treated as a sale otherwise than at arm's length. So far as (b) above is concerned, HMRC is inclined to argue that the mere existence of another commercial relationship will affect the terms of the sale. Whilst this will frequently not be so, it can be difficult to demonstrate the true position. Since in practice it may be difficult to meet the above conditions, it is generally

desirable to negotiate sales prices on a basis which is as near as possible to that laid down for sales which are otherwise than at arm's length (Paragraph 4.9) so as to reduce the scope for adverse adjustment. If, for example, oil from a field with offshore loading is sold FOB at the field in a sale which is not at arm's length as defined, the vendor will be taxed on the basis that the oil is notionally delivered onshore in the UK. He will therefore be taxed on the notional freight and insurance element which he will not in fact have received (but see Paragraph 4.20).

Section 2 (5A)

4.6 Where oil is sold in arm's length sales, the seller may be required to transport it from the place where it is first landed to a delivery point in the UK or overseas; or it may be required to meet the cost of such transport. In such cases, the actual sales proceeds and delivery date are both ignored for PRT. Instead, for both purposes, it is to be assumed that the oil is delivered at the nearest reasonable delivery point in the UK or (if the oil was first landed outside the UK) overseas. This establishes that effective reimbursement of costs will not be charged to tax beyond the point where the costs themselves are deductible (Appendix I.6 and I.7).

4.7 The Board has made regulations allocating sales of blended equity and non-equity oil proportionately across a company's fields, both taxable and non-taxable.

Section 114 FA 84

4.8 Where payment is received under a gas take or pay contract, that amount is treated as an advance payment for the gas. Gas subsequently delivered free of charge under the contract is treated as sold for a price equal to that advance payment. Where capacity payments are received under a sale contract, they are treated as additional proceeds of sale of the gas and are chargeable in the period in which they are received or receivable.

Deliveries of oil otherwise than at arm's length

Section 2(5B)
Para 3 Sch 3
Section 62
Sch 11 FA 87

4.9 This item consists of all deliveries of oil sold in transactions which do not qualify as sales at arm's length under the rules outlined in Paragraph 4.4 above. The amount to be taken into the computation is the aggregate market value computed in the manner laid down in the Act. The rules for establishing market value were radically amended with effect from 1 January 1987 and again from 1 July 2006 to take account of prevailing market practices and to remove uncertainties in the operation of the valuation regime.

4.10 Under the current rules, oil (not including light gases) delivered in a particular month in a non-arm's length sale is divided into Category 1 and Category 2. Category 1 oil (specified by Regulations) includes:

Para. 2 (1A) Sch. 3

- Brent blend
- Ekofisk blend
- Flotta blend
- Forties blend
- Statfjord oil.

4.11 The market value of Category 1 oil for a particular month is deemed to be the price at which oil of that kind might reasonably have been expected to be sold under a contract satisfying the following conditions:

Para. 2 (2) Sch 3

(a) it is for the sale of the oil at arm's length to a willing buyer;

(b) it is for the delivery of a single standard cargo of the oil;

(c) it specifies a period of three days within which the loading is to take place including the delivery day for the oil. The notional delivery day is the middle day of a three-day loading slot (The Treasury may make regulations substituting a notional delivery day or varying the loading slot);

(d) it requires the oil to have been subjected to appropriate initial treatment before delivery;

(e) it requires the oil to be delivered:

(i) in the case of onshore oil, at the place of extraction; or

(ii) in the case of offshore oil, at the place in the UK, or another country, at which the seller could reasonably be expected to deliver it or, if there is more than one such place, the one nearest to the place of extraction;

(f) normal commercial credit terms apply (HMRC considers this to mean payment within 30 days).

4.12 The market value of Category 2 oil is determined under the same conditions as for Category 1 except that (b) and (c) are adapted:

Para. 2 (2AA) Sch 3

(b) is for the delivery of the oil and the notional delivery day or within such period including that day as is normal at arm's length;

(c) the contract is made on such date as is normal for the notional delivery date in question.

Para. 2(2E/F) Sch. 3)

4.13 The price is prescribed by the Board of HMRC under Regulations. However, if the Board considers it impractical or inappropriate to apply the Regulations it may exercise its discretion.

SI 2006/3313

4.14 For each Category 1 oil, the Regulations prescribe the calculation of an average reference value for the notional delivery day and the addition of an adjustment factor.

4.15 The average reference value is found by taking the average of such values for the notional delivery day and 2 days each side. There are further rules for non-business days. There is also an anti-avoidance provision. Where the actual and notional delivery days differ and the sale or main advantage that might be expected from a non-arm's length sale is a favourable price differential, the price may be adjusted. This rule only applies where a participator's equity oil disposals equal at least 4 million barrels in any 2-year period.

4.16 The reference value is found in published material ie Argus, ICIS and Platts (the reference reports).

4.17 For Brent blend the adjustment factor consists of the daily average of the differential from the reference value published in the reference reports for the period from 21 to 14 days before the notional delivery date.

4.18 For other Category 1 oils parallel rules apply based on a differential from Brent.

4.19 For Category 2 oils two methods apply. The one producing a price closer to that which would have been realised in an arm's length sale is used:

(a) Method 1 – actual arm's length sale prices;

(b) Method 2 – value by differential from a marker crude.

4.20 Where HMRC is satisfied that it is impracticable or inappropriate LPG is valued differently from Crude. The old LPG methodology valuation was based wholly on HMRC reported values of term sales of equity, with separate values produced for butane and propane. Excluded from this valuation were spot sales, sales under 'month of entitlement' (MOE) contracts and non-equity

contracts as these were considered to give an unfair representation. From chargeable periods ending 31 December 2003 onwards the methodology was changed to include MOE contracts, as these accounted for a significant proportion of deals. At present HMRC are reviewing this methodology to try to eliminate any distortion of the valuation as a result of using bundled data.

4.21 Condensate sales are valued under the same rules as crude oil and LPG. However, as there is no homogeneity between condensate products in practice each field's production is valued individually following the statutory valuation method as far as practicable and appropriate. The oil industry has been concerned about the parameters of the discretion which may be exercised by HMRC in valuation matters and has sought to ensure that participators have effective appeal rights in matters of oil valuation.

HMRC has indicated that in its view the valuation rules do not restrict rights of appeal and that, on appeal against an assessment, the Special Commissioners (now the new tribunals) would have both a right and a duty to review any basis of valuation relied on by HMRC.

4.22 Where, prior to 1 January 1994, light gases such as ethane or methane were disposed of in non-arm's length sales or relevantly appropriated, the taxpayer could elect that the normal market value rules be suspended. Provided the Board of HMRC agreed, an alternative notional market value was computed based on a formula specified in the election. The aim of these provisions was to enable PRT valuations of light gases supplied under long-term contracts to mirror the terms under which comparable gas was actually sold in the open market. The detailed provisions are not discussed in this book. Though elections made before 1 January 1994 remain in force, no further elections may be made from that date. Instead, simplified valuation rules now apply. The market value will be the price, having regard to all relevant circumstances, at which those light gases might reasonably have been expected to be sold under a contract of sale meeting conditions similar to those outlined at Paragraph 4.11 (a), (d) and (e) for non-arm's length oil sales.

Sch. 18 FA 82
Sch. 21 FA 86
Para. 3A Sch 3

Relevant appropriation

4.23 Oil which is not sold by a participator but is relevantly appropriated is brought into the computation at aggregate market value computed as for deliveries otherwise than at arm's length.

4.24 Oil is relevantly appropriated when it is appropriated to refining or to any use except for production purposes in relation to the field of production or any other field in the UK or a designated area.

Section 12(1)

4.25 Production purposes are:

(a) carrying on drilling or production operations within a field; or

(b) in the case of oil won offshore, pumping it to the place of first landing in the UK, or to the place in the UK, or in another country, nearest to the place of extraction where a seller in a sale at arm's length could reasonably be expected to deliver it; or

(c) initial treatment.

Section 2(4)(b) & (5)(d)

Closing stocks and opening stocks

4.26 A participator is charged on one-half of the market value of so much of his share of oil won and saved as if he had either

(a) not disposed of and relevantly appropriated;

(b) disposed of but not yet delivered at the end, or at the beginning, of the chargeable period respectively.

In practice, HMRC will not seek to apply the market value rule to closing stock where a participator has no arm's length disposals or appropriations. In such cases, the value of closing stock is regarded as the same as the price on the final delivery of the relevant hydrocarbon for the last month of the chargeable period.

4.27 Stocks might include oil in the terminal facility and oil in storage onshore. Assessable profits and allowable losses

Para. 7 Sch.3

4.28 Oil in the course of being transported from an offshore field to shore at the end of a chargeable period is excluded from the calculations.

Accordingly, oil in a tanker or pipeline is ignored. In practice, the exclusion also extends to offshore storage.

Excess of nominated proceeds

Section 2(5)(e)
Section 61 FA 87

4.29 This item consists of any excess amount which a participator is obliged to include in the calculation of PRT gross profit as a consequence of the Nomination Scheme. The Nomination Scheme was introduced with effect from 1 March 1987 and provides for a complex system of nomination of oil sales contracts in advance of deliveries. It is relevant where a company buys and sells cargoes of crude of the same type, and is designed to eliminate a participator's ability to depress his PRT profits from arm's length sales by, in effect, choosing which contract, from a number of arm's length contracts, to satisfy by delivery of equity crude (the income from which would be subject to PRT) and which to satisfy by delivery of bought-in crude (the income from which would be outside the scope of PRT). It does this by providing that, in certain circumstances, an excess amount is to be brought into the PRT computation of gross profit.

4.30 The Scheme does not apply to oil which is gaseous at a temperature of 15°C and pressure of one atmosphere. Nor does it apply to oil of a kind which is normally disposed of crude by deliveries in quantities of 25,000 metric tonnes or less. However, since this latter exclusion looks to the kind or characteristics of the oil, rather than the circumstances of the participator, its main effect is to exclude from the Scheme onshore production and some categories of condensate, and not the production of a participator having a small interest in an offshore field. Therefore, the scheme will be relevant to most participators in offshore taxable fields.

SI 1987/1338

4.31 The Nomination Scheme is both complex and administratively burdensome and a detailed discussion is beyond the scope of this book. However, the main effects are that:

(a) where equity crude is delivered under an arm's length contract which has not been nominated (in advance and according to strict parameters and time limits), an additional amount may be brought into the gross profit calculation equal to the excess (if any) of the market value of the oil for the month of delivery over the actual sales proceeds;

(b) if a proposed transaction is nominated, but not satisfied from a participator's equity production, an additional amount may be brought into the gross profit calculation equal to the excess (if any) of the nominated proceeds over the actual proceeds of sale (or market value where appropriate) of that equity crude.

4.32 It is also to be noted that, with a view to countering other PRT avoidance devices, the market value in (i) above and the nominated proceeds in (ii) above may be multiplied in certain circumstances by a fraction not greater than 3⁄2 for any particular month, which is to be specified by HMRC. However, it would seem that this provision could not apply for a month for which there had been no nominations of proposed arm's length sales.

SI 2006/3089 & SI 2007/1454

4.33 Since 1 July 2006, only Brent – Forties – Osebeg ("BFO") or Brent – Forties – Osebeg – Ekofisk ("BFOE") forward contracts have been capable of nomination and that within 2 hours of fixing the contract price.

Tariff receipts

Section 6 OTA 83

4.34 Tariffs receivable from 1 July 1982 are brought into charge to PRT. They are amounts receivable (whether of a capital or income nature) by the participator in a taxable field, or by a person connected with him, in respect of:

(a) the use of a qualifying asset (Paragraph 4.36); or

(b) the provision of services of any kind in connection with the use, other than by the participator himself, of a qualifying asset.

Section 6 (4)(c) OTA 1983

4.35 Tariff receipts may be income or capital in nature and may be payments in cash or in kind. They do not include interest and other financing payments or consideration for deballasting. They include receipts from use in respect of non-UK fields and non-taxable fields. Also, foreign licensees who derive tariffs from users who are UK licensees are chargeable in respect of UK and Continental Shelf source receipts, though double taxation relief may be available under the terms of any applicable double tax treaty. The charge applies with modifications even when the chargeable field is one which produces 'exempt gas' (Paragraph 3.2). For receipts from 1 July 2009 they no longer include income from non-oil uses.

Section 8(1) & (3) OTA 83

4.36 A qualifying asset is a long-term asset (Paragraph 5.8) which is either not mobile or, if mobile, is dedicated to the particular taxable field and in respect of which the participator may obtain or has obtained PRT expenditure relief for that field. The tariff is attributed to the field for which the expenditure is or was allowable. If there is more than one such field, it is usually attributed to the field for which a development decision was first made. Where development decisions have been made in respect of more than one field on the same day

(as is usual for cluster developments), it will be attributed to the field in which the participator is likely to make the greatest use of the asset. If the receipts are referable to a mobile asset, fields to which it is not dedicated are ignored. No account is taken of any taxable field in relation to which an asset is a qualifying asset only by virtue of it being an associated asset (Paragraph 5.10). Tariffs from an associated asset are attributable to the field to which receipts referable to the asset with which it is associated are attributable.

Tariff receipts allowance

Section 9
OTA 83

4.37 Qualifying tariff receipts from each individual user field other than the chargeable field are reduced by a throughput allowance of the cash equivalent of 250,000 metric tonnes per field per chargeable period.[2]

There is no restriction on the number of chargeable periods for which the allowance is available and, unlike oil allowance, there is no cumulative limit.

4.38 The term 'user field' does not include non-taxable fields (except those which are only non-taxable by election (Para. 2.4) : any throughput from these does not qualify for tariff receipts allowance.

It does include any non-UK field which has been designated as a 'foreign field' by an order of the Secretary of State. However, as from 1 July 1993, no further such orders can now be made.

4.39 The cash equivalent of a participator's share of the tariff receipts allowance is computed by the following formula:

$$\pounds(A \times \frac{B}{C})$$

where A = receipts received or receivable by the participator;
B = the allowance for the field in metric tonnes; and
C = the amount of oil in metric tonnes to which those receipts relate (ie, the total throughput from that user field).

If $\frac{B}{C}$ exceeds unity, it is to be treated as unity.

There are provisions dealing with the situation where tariffs received in a chargeable period relate to use in more than one chargeable period.

[2] 375,000 metric tonnes for agreements made before 8 May 1982 for chargeable periods ending on or before 30 June 1987.

Other special provisions

Paras. 2 & 11 Sch. 2 OTA 83

4.40 The charge to PRT does not apply to independent contractors as they will not be holders of an interest in an oil licence. However, there are special provisions regarding PRT or corporation tax avoidance schemes or arrangements. Where receipts are diverted so that they are received by a person connected with a participator, they are deemed to be received by the participator. Where an asset is owned by a person connected with a participator, receipts (excluding those from the connected participator) may be allocated to the participator together with a reasonable portion of the expenditure on the asset.

Section 238 FA 94

4.41 Where a participator in a taxable field disposes of an asset, after 30 November 1993, to a connected person who is also a participator in any field, and that asset is subsequently used to generate tariff receipts, then, for the purposes of determining the disposal proceeds or tariff receipts (as the case may be) of the vendor, the disposal will be deemed to be made at open market value. Where, however, the purchaser uses the asset solely in connection with a taxable field, so that tariff receipts are not generated, then the receipt on the disposal will only be subject to PRT (as disposal or tariff receipts) to the extent that, in aggregate, it exceeds the vendor participator's allowable PRT expenditure.

4.42 Tariff receipts receivable by a person in respect of a dedicated mobile asset cease to be chargeable from approximately two years after its use ceases in any field in which that person (or any person connected with him) is a participator, unless they relate to use before the end of those two years.

4.43 Where a participator puts through his system oil which he has purchased from another participator, any profit which he makes on sale is treated as a tariff receipt. This provision does not apply to oil for which market value is brought into account on a non-arm's length sale.

Sections 231-234 FA 94

4.44 A participator in a taxable field is entitled to make an election (restricted to recently-developed fields) which, broadly, will exclude from the charge to PRT tariffs received from participators in non-taxable fields and sums receivable on the disposal of tariff-generating assets. In return, there is a restriction of PRT relief for expenditure on the associated tariff-earning assets. The election may only be made in relation to fields containing a pipeline in excess of 25km

long which has initial spare capacity of a least 50 percent and which is intended to be used to earn tariff receipts. There are a number of detailed provisions, discussion of which is outside the scope of this book.

Tax-exempt tariffing receipts

4.45 As a result of a consultation process in 2002, which addressed industry concerns that pipeline owners in the UKCS were at a commercial disadvantage in the competition for tariff income in respect of gas from Norwegian gas fields due to the additional cost of the PRT charge, the tax-exempt tariffing receipt (TETR) rules were introduced. These rules exempt qualifying tariff receipts from PRT.

4.46 TETRs received or receivable in a chargeable period ending on or after 30 June 2004 are not regarded as tariff receipts for the purposes of PRT.

Definition of TETR

OTA 83
Section 6A(2)

4.47 An amount is a TETR for these purposes if it:

(a) Would otherwise be a tariff receipt of a participator in an oil field;

(b) Is received or receivable by the participator in a chargeable period ending on or after 30 June 2004 under a contract entered into on or after 9 April 2003; and

(c) Is in respect of tax exempt business.

Tax-exempt business

OTA 83
Section 6A(3)

4.48 An amount is in respect of tax-exempt business if it is for the use of a qualifying asset, or the provision of services or other business facilities of any kind in connection with the use (other than by the participator in the oil field) of a qualifying asset.

Qualifying asset

OTA 83
Section 6A(4)

4.49 A qualifying asset is one which is used in respect of:

(a) A new field, or oil won from a new field (i.e. a field for which development consent was granted on or after 9 April 2003, including a foreign field). A foreign field is any hydrocarbon accumulation which is not under the UK's jurisdiction.

(b) A qualifying existing field or oil won from such a field (i.e. any field which is not a new field and which has not made use of a disqualifying asset at any

time in the 6 years before 9 April 2003). A disqualifying asset is the use of a qualifying asset used by a participator in relation to an oil field, unless it was an excepted asset. Excepted assets include qualifying assets that were permanently situated inside the boundaries of the field; or

(c) a UK recommissioned field (Para. 2.4).

Related expenditure

4.50 To reflect the fact that TETRs are not charged to PRT, expenditure (incurred on or after 1 January 2004) related to the use or expected use of an asset, or the provision of any services or other business facilities of any kind in connection with that use for TETR purposes is not allowable for PRT.

Expenditure incurred on long-term assets

OTA 83
Section 3A

4.51 Where a long-term asset is used, or expected to be used, for tax exempt tariffing purposes, the amount of expenditure that it is just and reasonable to apportion to the use, or expected use, for tax exempt tariffing purposes is excluded from the allowable expenditure. HMRC states that expenditure incurred for long-term assets should be allocated by reference to the fields expected to use the assets on the basis of their expected recoverable reserves.

Expenditure other than on long-term assets

4.52 Where expenditure is incurred partly for tax exempt tariffing purposes and partly for one or more of the qualifying purposes listed at Section 3(1) OTA 1975 which include searching for oil anywhere within the area of the field, making a payment to obtain a relevant licence and winning oil from the field, it should be apportioned on a just and reasonable basis. Initially, it was HMRC's view that a just and reasonable apportionment of operating expenditure should be found in connection with an asset by reference to throughput.

4.53 During the development of the TETR legislation, concerns were raised by industry over how cost allocation should apply in TETR situations, particularly that a throughput basis of apportionment was not necessarily appropriate in all cases, and could reduce the effectiveness of the rule changes. HMRC accepted that there was a case for modifying the approach to general cost allocation in some TETR situations, in order to ensure that a just and reasonable apportionment is achieved. Where this modified approach applies, the expenditure applicable to TETR use will be the amount equivalent to

50 percent of the gross tariff from the user field, subject to the limitation that the expenditure allocated cannot exceed average cost or be less than the incremental cost. To utilise the modified approach, HMRC has stated that the responsible person for the host field should agree with HMRC that the modified approach should be applied.

Asset disposal receipts

4.54 Disposal receipts received or receivable from 1 July 1982 (including insurance proceeds for loss or destruction of an asset) in respect of qualifying assets (or interests therein) by participators or connected persons are chargeable. This item specifically includes amounts received on redetermination adjustments of transmedian line fields.

Section 7(1)-(5) OTA 83

4.55 Sums received more than two years after an asset ceases to be used for any oil field or to produce tariff income are exempt. Interest receipts and receipts in respect of the disposal of an interest in oil won or to be won from a field are not chargeable. A sum is not chargeable to the extent that it arises on the disposal of an asset which has been the subject of an election under Paragraph 4.44 above. Sales proceeds attributable to assets which arise on the transfer of a taxable field interest are not chargeable where the special provisions relating to the transfer of field interests apply (Paragraph 15.19). If the asset disposed of is a brought-in asset, the proceeds are scaled down in the same proportion as allowable cost. Other detailed provisions are similar to those for tariff receipts.

Para. 19 Sch. 17 FA 80

Para. 9 Sch. 2 OTA 83

4.56 For acquisitions and disposals on or after 1 July 1999, new anti-avoidance provisions were enacted and apply where a participator receives chargeable income from a qualifying field asset which is no longer chargeable to PRT. This could arise where the chargeable field is transferred to another company without a disposal charge arising on the asset; or as a result of the acquisition of an interest in an older field that uses the asset. The anti-avoidance measures prevent this situation by ensuring that tariff and disposal receipts continue to be attributed to the current chargeable fields in certain circumstances.

Section 98, FA 99

4.57 If proceeds arise in a period where uplift is available, uplift is to be reduced by the proportion which the proceeds (or allowable cost if less) bear to upliftable expenditure for the period.

Licence debit or credit

4.58 The licence debit or credit is calculated as follows although the royalty elements are no longer relevant (see Paragraph 4.60):

	Item	£	£
Section 2(7)(a)	1 Royalty payable for the chargeable period	A	
Section 2(7)(b)	2 Royalty paid in the chargeable period	B	
Section 2(7)(c)	3 Other periodic licence payments to the Secretary of State made in the chargeable period	C	D
	Less		
Section 2(6)(b)(i)	4 Royalty payable for the preceding chargeable period	(E)	
Section 2(6)(b)(ii)	5 Royalty repaid in the period	(F)	(G)
	Licence debit or credit		H

4.59 Royalties were payable for periods which coincided with chargeable periods. The object of the method of calculation shown above was to allow deduction for royalties on an accruals basis.

Licence payments other than royalties

Section 118
FA 81

4.60 Following abolition of royalty from 1 January 2003, the licence debt and credit mechanism largely falls away save for annual rentals.

4.61 Payments from or to the Secretary of State not otherwise dealt with in the PRT legislation are included as positive or negative amounts respectively in computing assessable profits or allowable losses when received or paid (see item 3 in Paragraph 4.58). This deals with annual licence rentals that are generally calculated by reference to the acreage of the licensed area. Payments relating to more than one field must be apportioned on a just and reasonable basis.

Debit or credit in respect of expenditure

4.62 This is dealt with in Chapters 5 and 6.

Relief for allowable losses

4.63 Where an allowable loss arises in respect of any chargeable period it may be set off against the assessable profits (if any) arising in that field in earlier chargeable periods, taking the most recent first. To the extent that it is not relieved against earlier chargeable periods, a loss will be carried forward and deducted from the first available assessable profits of succeeding chargeable periods arising in the same field.

Section 7

4.64 There is no facility to offset losses arising in one field against profits arising in another field in normal circumstances. However, when a taxable field closes down permanently, losses which cannot be relieved under the provisions mentioned above may be treated as expenditure incurred at that time in any other field in which the participator is also a participator (Paragraph 6.11).

Section 2(9)(e) & 6

4.65 It should be noted that where loss relief is allowed, it may have the effect of displacing oil allowance (Chapter 7) or may be rendered nugatory by safeguard (Chapter 8). Thus effective relief may be less than might be anticipated.

Chapter 5

Relief for field expenditure

5.1 The relief for expenditure allowed to a participator for PRT purposes is known as the 'debit or credit in respect of expenditure' and has the following key features:

- As a general rule, only expenditure relating to a field and incurred for specified purposes is deductible against the profits from that field. However, special reliefs may be available in respect of certain types of expenditure not relating to the field. These special reliefs are dealt with in Chapter 6.
- Certain types of expenditure are specifically excluded from deduction. Of these the most important is interest. In its place an uplift is allowed on certain qualifying expenditure (Paragraph 5.19).
- Expenditure is only deductible in an assessment after it has been both claimed and allowed by HMRC. In recognition of this fact a provisional allowance is given (Paragraph 5.37).
- There is no distinction between revenue and capital expenditure and, apart from expenditure on certain long-term assets, expenditure is normally allowable in full as it is incurred.

Section 191(1) FA 93

- Until FA 1993, a definition of when expenditure is incurred was not provided in the Oil Taxation Acts. FA 1993 introduced such a definition for expenditure included in a claim received by HMRC after 16 March 1993. It provides that expenditure is deemed to be incurred for PRT purposes when the obligation to pay becomes unconditional, even if the payment is not due until a later date. Stage payments and similar items may be claimed provided that they are not disproportionate to the stage the contract has reached.

The items which comprise the debit or credit in respect of expenditure are set out below:

Debit or credit in respect of expenditure	Para	£	£	
Participator's share of expenditure claimed by responsible person				
Normal expenditure	5.3	A		Section 2(9)(b)
Long-term assets	5.8	B		
		C		
Uplift – 35% of qualifying expenditure	5.19	D	E	
Expenditure claimed by participator				
Normal expenditure	5.3	F		Section 2(9)(c)
Long-term assets	5.8	G		
			H	
Uplift – 5% of qualifying expenditure	5.19	I	J	
5% of gross profit (excluding stocks) of chargeable period	5.37	K		Section 2(8)(b) & (9)(a)
Less 5% of gross profit (excluding stocks) of last but one chargeable period (as adjusted)		L	M	
			N	
Exploration and appraisal expenditure	6.2		O	Section 2(9)(f)
Abortive exploration expenditure	Appendix III.13		P	Section 2(9)(d)
Research expenditure	6.3		Q	Section 2(9)(g)
Cross-field allowance	6.7		R	Section 65 FA 87
Unrelievable field losses	6.11		S	Section 2(9)(e)
Debit in respect of expenditure			T	

5.2 As noted above, expenditure is only allowed after it has been agreed by HMRC, and a claim alone is not sufficient. For this reason the administrative procedures are of some importance; these are considered in more detail in Chapter 10. The principal administrative point to be noted is that, in general, claims for both normal and long-term expenditure on joint property are to be made by the responsible person for the field (Paragraph 10.3) on behalf of all the participators. The total amount claimed is then to be allocated amongst the participators. HMRC generally takes the view that this must be in accordance with field equity percentages, regardless of how the expenditure was actually incurred. It now accepts that expenditure incurred prior to the development phase of a taxable field may be allocated as it was actually incurred. Where

Section 2(9)

expenditure which is not common to all participators is undertaken, details should be given to the responsible person who will then include that expenditure in a claim for the field. In theory, expenditure may be directly claimed by the participator himself only if HMRC is satisfied that, for reasons of trade secrecy, it would be unreasonable to provide the responsible person with the information necessary to make the claim. In practice, HMRC has generally accepted that such claims may be made wherever expenditure has been incurred by individual participators and not by the operator on behalf of the whole consortium. Claims by the responsible person and by the individual participator are generally referred to respectively as Schedule 5 and Schedule 6 claims.

Allowable expenditure

Sections 3(1) & 12(2)

5.3 Expenditure relating to a taxable field (other than on long-term assets) is allowable only if it falls into one or more of the categories in the table below.

		£
Section 3(1)(a)	Searching for oil	A
Section 3(1)(b)	Licence payment (other than royalties or rentals)	B
Section 3(1)(c)	Delineation	C
Section 3(1)(d)	Winning oil	D
Section 3(1)(e)	Measuring the quantity of oil	E
Section 3(1)(f)	Transport to land	F
Section 3(1)(g)	Initial treatment and storage	G
Section 3(1)(h)	Sale of crude oil at arm's length	H
Section 3(1)(hh)	Obtaining an abandonment guarantee	I
Section 3(1)(i)	Abandonment costs	J
Section 3(1)(j)	Site restoration work	K
Para. 2A Sch. 5	Payment of defaulter's abandonment expenditure	L
Section 3(2)	Statutory redundancy payments	M
	Allowable expenditure	N

Section 185(6) FA 93

Sections 3(7) & 8

5.4 The scope of each category is considered in more detail in Appendix I. All expenditure incurred (Paragraph 5.1) by a person on a taxable field, even before he becomes a participator in the relevant field, may be claimed. No distinction is made between capital and revenue expenditure. Expenditure which is incurred partly for one or more qualifying purposes and partly not is apportioned. Similarly, expenditure incurred partly on a taxable field and partly on a non-taxable field is apportioned. Expenditure incurred in connection with

a long-term asset which gives rise to tariff receipts is treated as attributable to a qualifying purpose. On introduction of the TETR rules, costs associated with the exempt tariff are not allowable for PRT purposes. Costs incurred partly on tariff exempt business and partly on taxable business are apportioned (Paragraph 4.45).

5.5 Although expenditure may only be claimed when it falls into one of the categories mentioned, these are described in fairly general terms and, in practice, it should be possible to allow almost all presently foreseeable commercial items of expenditure. In relation to newer technology, the Special Commissioners allowed a claim by BP (in BP Exploration Operating Co Ltd v. CIR) [SpC 254, July 2000] for expenditure in relation to the design and installation of facilities known as a marine vapour recovery system. Nevertheless, there are sometimes difficulties with allocation of mixed functions, research and development and overheads.

Excluded expenditure

5.6 Certain items are specifically excluded from deduction. Of these, the most significant is interest or any similar expense. Its place is taken by a supplement of 35 percent on certain qualifying expenditure (see Paragraph 5.17). The categories of excluded expenditure are as below:

Excluded expenditure	
Interest	Section 3(4)(a)
Land	Section 3(4)(b)
Buildings onshore	Section 3(4)(c)
Expenditure determined by reference to production from or profitability of the field	Section 3(4)(d)
Payments to obtain any interest in licences or production other than those made to the Secretary of State	Section 3(4)(e)
Payments in respect of tax assessed on non-resident contractors	Section 3(4)(f)
Expenditure matched by a receipt under an abandonment guarantee	Section 105
Relief for field expenditure	FA 91

5.7 These items are considered in more detail in Appendix II. They are of considerable importance and should not be overlooked. There are also a number of restrictions which apply to expenditure otherwise than at arm's length, to situations where production commenced before 13 November 1974 and to subsidies. These are also dealt with in Appendix II.

Long-term assets

Section 3(1) & (8) OTA 83
Section 3(2) OTA 83

5.8 A long-term asset is one whose useful life continues after the end of the claim period (Paragraph 10.17) of six or 12 months in which it is first used. Although the definition applies to all expenditure, whether of a capital nature or not, the principal application will be to capital expenditure. The special rules do not apply where HMRC consider that they would have only a negligible effect on the total expenditure allowable and make a direction to that effect.

Section 3(1) OTA 83 & Sections 12(2) & 3(6)

5.9 Generally, full relief will be given for expenditure incurred after 30 June 1982 on acquiring, bringing into existence or enhancing the value of a long-term asset, other than a non-dedicated mobile asset (Paragraph 5.12), even if it is not anticipated that the asset will be used exclusively for the field. The asset must be used, or expected to be used, in connection with a taxable field in which the person incurring the expenditure is a participator for one or more of the qualifying purposes specified in Paragraph 5.3 above. If an asset is used only partly for a qualifying purpose, then an apportionment of expenditure must be made, and only that part which relates to use for a qualifying purpose is allowable. From 1 July 2009 use of an asset otherwise than for oil production purposes will no longer result in a disallowance.

Paras. 1 & 2 Sch. 1 OTA 83

5.10 If a person incurs expenditure on an asset which is not used directly in connection with a taxable field ('principal field') in which he is a participator, but the asset is used to earn tariffs in association with another asset which is used for the principal field, relief for that expenditure will be available under the associated asset provisions. The relief may, however, only be allowed in line with receipts if the asset is a remote associated asset (i.e., an asset some part of which is more than 100 metres from the nearest part of the asset in association with which it is used). Special provisions also apply to expenditure incurred by participators in foreign fields where they derive receipts chargeable to PRT from field assets.

Paras. 10-12 Sch. 4 OTA 83

5.11 Where an asset is used in more than one field by a participator, the expenditure is to be apportioned between those fields on a just and reasonable basis, with any part relating to use in a non-taxable field disallowed. If the asset is also used to earn tariffs, generally that part of the expenditure on the asset attributable to tariff use is to be allocated to the taxable field in which those tariffs are chargeable (Paragraph 4.36). Thus, there is some symmetry between the expenditure and the related receipts.

Section 190(1) FA 93
Section 4(7)-(9)
Section 4 & Section 1 OTA 83

5.12 Mobile assets which are not dedicated to a particular field obtain a deduction for that part of the cost of the asset which corresponds to the proportion which the period of use in the field to the end of the claim period bears to the estimated life of the asset. For each period subsequent to that in which expenditure on a mobile asset is incurred, the cumulative amount allowable is recalculated and any necessary adjustments made. Special rules apply to certain disposals for valuable consideration, and to other situations where an asset is not used exclusively for the field. Where a non-dedicated mobile asset becomes dedicated to a particular taxable field, these provisions cease to apply and relief becomes available for unrelieved expenditure subject to the normal conditions. Where a non-dedicated mobile asset becomes dedicated to a non-taxable field during a claim period, any unrelieved expenditure is to be apportioned on a time basis and the amount relating to the period of use in the non-taxable field is not allowable.

5.13 Expenditure on long-term assets incurred before 1 July 1982 was dealt with under the rules described in Paragraph 5.12 above for non-dedicated mobile assets, except that the proportion of cost allowed was generally based on the estimated use of the asset within the field over the whole of its projected life, and not just on actual use to the end of the claim period. In most cases 100 percent of the cost was allowed when the expenditure was incurred, although where it became apparent that an asset would be used outside the field, a recapture of expenditure allowed was required.

5.14 A recent case heard by the First-Tier Tribunal (Talisman Energy (UK) Limited v The Commissioners for Her Majesty's Revenue and Customs) considered the issue of dual use expenditure between a PRT and a non-PRT field and whether the expenditure was allowable in the PRT field. Broadly, the expenditure was incurred on tie-back arrangements to allow the taxable field access to fuel gas and lift gas from the non-taxable field.

The Tribunal found that the legislation envisages dual purpose use such that an asset can be used in connection with more than one field and for different purposes in different fields. An apportionment of expenditure is likely in these cases.

Furthermore, it was determined that the requirement (relevant to the facts of the case) that the asset is to be used for the purpose of winning oil can be satisfied directly and indirectly. For these purposes, it was therefore

irrelevant whether the asset was located within the field in question or not and that there was dual use. The key issue to consider in such cases, other than appropriate apportionment, is whether the asset is, or is expected to be, used in connection (construed broadly by the Tribunal) with the field that is seeking to claim the expenditure. The Tribunal found that the assets in question were so used and allowed the claim for expenditure.

It is not known whether HMRC will appeal the case.

5.15 See Chapter 16 for comments on "Change of Use".

Assets subject to sale and leaseback

Section 95 FA 99

5.16 Provisions were introduced in the Finance Act 1999 to combat PRT avoidance resulting from the sale and leaseback of North Sea assets. The anti-avoidance provisions apply to disposals by field participators on or after 9 March 1999 of all or part of an asset which qualified for PRT relief in relation to that field and, within two years of the disposal, that asset is leased for use in a field by the seller or a connected person.

5.17 A cap is placed on the amount of lease expenditure available for PRT purposes, being equal to the proceeds received on disposal of the asset, thus preventing any deduction for lease finance charges. Where the disposal proceeds were sheltered from PRT by safeguard relief, the cap is further limited to the proceeds actually charged to PRT.

Section 96 FA 99

5.18 These restrictions will continue to apply where, following a sale and leaseback transaction, the lessee transfers all or part of an interest in the field to a new participator and that person continues to use the asset under a lease in that field.

Expenditure qualifying for uplift

Section 3(5)

5.19 In recognition of the fact that no deduction is allowable in respect of interest, certain expenditure qualifies for an uplift, and it will be seen that most major items are covered. Expenditure qualifies for uplift when it is incurred for one or more of the following purposes:

(a) bringing about the commencement of the winning of oil from the field or the commencement of transporting it to the UK or another country (this would not include revenue expenditure incurred in the course of production);

(b) ascertaining the extent or characteristics of any oil-bearing area wholly or partly included in the field, or the reserves of any such area;

(c) carrying out works for, or acquiring an asset for, substantially improving the rate at which oil can be won from the field or transported to the UK or elsewhere, or preventing or substantially reducing a decline in that rate;

(d) providing any installation for the initial treatment or initial storage of oil won from the field.

Section 3(5A)

Allowable expenditure incurred partly for one of these purposes and partly to enable an asset to be used to give rise to tariffs is treated as wholly eligible for uplift. Expenditure incurred solely to enable an asset to be used to give rise to tariffs does not qualify for uplift.

5.20 Expenditure incurred in hiring an asset is only eligible if it is used to carry out works for any of the purposes mentioned in (a) to (c) above, or works for the provision of any installation of the kind mentioned in (d) above.
Relief for field expenditure.

5.21 It has become apparent that (c) above could be applied to a wide range of expenditure. In practice, HMRC seeks to restrict its application to major workovers and improvements which enhance the potential of a field.

Section 19(1) F(No 2)A 79

5.22 The rate of uplift is 35 percent for expenditure contracted for after 31 December 1978.[1]

Section 7(6) OTA 83 & Section 4(10)

5.23 Where adjustments in respect of long-term expenditure result in a reduction of allowable expenditure (Paragraph 5.12), the uplift for the period is to be restricted by the proportion by which the total long-term expenditure is reduced. It will be apparent from the above that clawbacks of expenditure on long-term assets do not create an automatic clawback of uplift, but merely restrict or eliminate the uplift which would otherwise be available. It follows from this that the clawback will be at the rate of uplift prevailing and not at the rate which was originally granted. Disposal receipts (Paragraph 4.54) also have the effect of restricting the amount of uplift due for the chargeable period in which they arise.

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[1] Previously the rate was 75 percent. A transitional rate of 66⅔ percent applied to expenditure contracted for before 31 December 1978, but arising from an alteration or addition to the contract made at the request of the participator after that date.

Prevention of uplift after payback

Section 111 FA 81

5.24 Expenditure incurred after 31 December 1980 does not qualify for uplift if it was incurred after the end of the first net profit period for a field.[2]

5.25 It should be noted that this restriction is calculated for each participator separately and is given effect by eliminating uplift in computing the assessment for the participator. The actual expenditure allowed and uplift allowed on the expenditure claim remains unaffected.

5.26 The net profit period is the period in which the total assessable profits for the participator concerned exceed the aggregate of the total allowable losses and APRT (net of certain repayments) arising from the field to date.

The computation may be illustrated as follows:

	Net profit	£	£
Section 111(3) FA 81	Assessable profits (ignoring oil allowance, tariff receipts allowance and losses set off)		A
Section 111 (3) (a) FA 81	E & A, abortive exploration and research expenditures and unrelievable field losses allowed		B
Section 65(4)c FA87	Cross-field expenditure allowed		C
Section 111 (3) (c) FA 81	* Expenditure clawback on long-term assets effected in the next period under Para. 6 Sch. 4 OTA 1975		D
		E	
Section 111(2) FA 81	**Less** allowable losses	(F)	
Section 111 (4) (a) FA 81	*Expenditure incurred and allowed for claim periods beginning before the end of the chargeable period allowed after assessment for period raised plus uplift	(G)	
Section 111 (3) (b) FA 81	Expenditure spread forward	(H)	
Section 111(2) FA 81	APRT paid	(I)	(J)
		K	

Note: All items other than those marked * are cumulative for all periods to date.

[2] Unless it was incurred before 1 January 1983 in pursuance of a contract made before 1 January 1981. In CIR v. Mobil North Sea Ltd. [1987] STC 458, it was held that uplift was preserved for expenditure incurred prior to 1 January 1983 to which an operator was contractually committed before 1 January 1981, even though the immediate obligation to pay may have arisen under a contract entered into after that date.

5.27 Expenditure claims should include claims for uplift unless it appears to the responsible person that none of the expenditure is likely to be eligible by reason of these provisions. This caters for the situation when all the participators are past their net profit periods. Similarly, the computation of the payment on account should proceed on the basis that uplift is available if the participator believes it is. This will not, however, stop interest running should the computation be incorrect.

Section 111(6) FA 81

5.28 Where there has been a transfer of an interest in a taxable field within Schedule 17 FA 1980 (Paragraph 15.19) there are rules designed to produce a similar result. The new participator's net profit period is the earlier of:

Section 112 FA 81

(a) his own net profit period, computed on the assumption that the profits and losses of the old participator accrued to him. Where only part of an interest is transferred, appropriate adjustments are to be made; and

(b) the old participator's net profit period (though this is ignored if the new participator had already been a participator, and had reached his own net profit period before the transfer).

5.29 For chargeable periods ending after 30 June 1985, the net profit period can only occur after a development decision has been made for the field. This removes the anomaly whereby the net profit period could occur during an extended production test, thus severely restricting uplift.

5.30 If a field goes back into net loss within three years after the net profit period, uplift may continue for expenditure incurred up to the end of the earlier of:

Section 113 FA 81

(a) the period in which net profit is next achieved;

(b) three years after the first net profit period.

Prevention of uplift for contracts with deferred payment

5.31 Uplift will only be available for expenditure pursuant to contracts for £10 million or more if it is reasonable to expect at the time the contract is made that either:

(i) not less than 90 percent of the price will be paid within nine months of commencement of performance; or

Section 115 FA 81

(ii) adequate progress payments will be made.

For (i) above, contract provisions allowing for price variations to take account of changes in cost or design are ignored. Adequate progress payments are made if amounts payable from commencement of performance are at least 75 percent of what would have been payable if they:

(a) were required every six months from commencement of performance of the contract;

(b) were proportionate to the extent of performance.

Where periodic or stage payments are required within three months of completion of any period or stage, it is to be assumed payment is required on completion of the period or stage.

Spreading elections

5.32 For the purposes of PRT no distinction is normally made between capital and revenue, and all expenditure is normally allowable as agreed with HMRC (subject to the special calculations required for non-dedicated mobile long-term assets (Paragraph 5.12)). Since the bulk of the expenditure incurred in relation to an oil field is normally undertaken at the outset of the project before revenue arises, there will typically be large deficits in early chargeable periods, and assessable profits will only arise after the initial project expenditure has been recovered. However, once that has occurred, there may be very little expenditure to set against income and PRT will therefore be payable on the bulk of a participator's oil revenue. Where a participator is owned overseas, it may be that the way in which double tax relief is granted in the country in which the owner is resident is such that this pattern is disadvantageous.

Para. 9
Sch. 3

5.33 Prior to chargeable periods beginning after 30 June 2009, the participator may elect that:

(a) only a specified part of upliftable expenditure which would otherwise be taken into account for a chargeable period be included;

(b) the balance and uplift be allowed in equal parts over the next three, five, 10, 15 or 20 chargeable periods.

He may also, by a further notice, elect to have the unallowed balance at any point allowed in one sum and not spread over the remainder of the period.

5.34 There is a tight time limit. All elections must be given within five months (extended by HMRC concession from the statutory limit of three months) from the end of the chargeable period concerned or, if later, within 27 months of the end of the first chargeable period for the field.

The election is not by reference to claim periods, but by reference to chargeable periods. Since expenditure is not necessarily allowed against chargeable periods coinciding with claim periods, difficulties may result unless the making of elections and other assessment matters are specifically agreed in advance with HMRC.

5.35 Where an election affects liability for the first four chargeable periods of a field, interest on overpaid or unpaid PRT will not run for any period before the election.

5.36 A spreading election will have no effect on either oil allowance or safeguard, both of which will be computed as if no election had been made (Paragraphs 7.11 and 8.4).

Five percent gross profit allowance and clawback

5.37 The relief described below is no longer available, the last period for which it was given was that ending 30 June 2009. Clawback, according to the rules below, may therefore apply for the two succeeding periods. No further clawback will arise for periods ending after 30 June 2010.

Sch 43 FA 09

5.38 The intention of this item is to permit a notional deduction in recognition of the fact that it may not be possible to submit and agree claims for all field expenditure incurred during a particular chargeable period before the assessment for that period is made.

5.39 The amount which is allowed is 5 percent of gross profit for the chargeable period as returned by the participator, ignoring both the opening and closing stock and any excess of nominated proceeds.

Section 2(9)-(11)

This is reduced by any field expenditure incurred in the period (period 1) which is allowable against the assessment for the period. In the succeeding period (period 2), the allowance is clawed back to the extent that any expenditure

incurred in period 1 is allowed against the assessment. In period 3, the balance of the allowance (if any) is clawed back. The calculation may be represented as follows:

		£
Chargeable period 1		
5% of gross profit excluding opening and closing stock and excess of nominated proceeds		A
Less expenditure incurred in period 1 and allowed in assessment for period 1	(B)	
Allowance . . .	C	
Chargeable period 2		
Expenditure in period 1 allowed against assessment for period 2		
Clawback . . .	D	
Chargeable period 3		
Balance of allowance (if any)		
Clawback . . .	E	

5.40 The formula adopted in the legislation is rather more complicated since, in any particular chargeable period, allowance and clawback items may arise in relation to the expenditure of up to three chargeable periods.

Chapter 6

Relief for non-field expenditure

6.1 Whilst the general rule is that only expenditure incurred (Paragraph 5.1) in relation to a taxable field is allowable against the profits from that field, there are a number of special reliefs which are described below.

Exploration and appraisal expenditure

6.2 Relief against field profits for exploration expenditure unconnected with the field was abolished from 15 March 1993. A summary of the relief is given in Appendix III.

Research expenditure

Section 5B

6.3 Certain research expenditure incurred by a participator after 16 March 1987, which relates wholly or partly to oil exploration and production in the UK or designated areas, but to no particular taxable field, may be claimed for relief against the profits of any taxable field in which the participator has an interest. To qualify, the expenditure must be incurred for research purposes of such a kind that, if it had been incurred in relation to a particular field, it would have qualified under the normal rules for field expenditure. Research is intended to be interpreted widely and to include, for example, research into alternative production systems or tertiary recovery techniques.

6.4 Where expenditure qualifies, it does not become allowable until the expiry of three years after the time it was incurred, and then only if it can be shown that it has not become allowable in any particular taxable field. Where the expenditure is incurred only partly for UK purposes a just and reasonable apportionment is to be made. Similarly, no deduction is due to the extent that the expenditure is for purposes relating to non-taxable fields. Research expenditure which qualifies for exploration and appraisal relief, or which would qualify but for the fact that it was incurred in relation to onshore areas, does not qualify for relief under these provisions.

6.5 Where a person becomes a participator in a field after the end of its first chargeable period, only research expenditure incurred after he becomes a participator is allowable against his profits from the field.

Section 5B (7)

6.6 Where qualifying research expenditure gives rise to any receipt by the participator or a connected person, it is set off against the expenditure otherwise allowable. If it is received after the expenditure has been allowed, it is treated as a positive amount in the PRT computation.

Cross-field allowance

Section 65 & Sch. 14 FA 87

6.7 A participator may make an irrevocable election for up to 10 percent of certain expenditure incurred after 16 March 1987 in connection with an offshore taxable field outside the southern basin of the North Sea (the field of origin), which first receives development consent after that date, to be allowed in any other field (the receiving field) in which he is a participator. To qualify, the expenditure must be allowable under the normal rules (outlined in Paragraphs 5.18-5.29) as qualifying for uplift in the field of origin and must not be expenditure qualifying for exploration and appraisal relief. No election can be made until the relevant expenditure has been claimed in the field of origin and allowed by HMRC as qualifying for uplift (see also Paragraph 10.37).

6.8 Relief is not available for expenditure incurred prior to a company becoming a participator in the receiving field where its interest in that field was acquired after the end of its first chargeable period.

6.9 Expenditure for which an allowance is taken in a receiving field is not allowed in the field of origin. Moreover, uplift on that expenditure is forgone and it is not added to the safeguard capital expenditure base (Chapter 8) in either the field of origin or the receiving field.

6.10 Relief may also be claimed for qualifying expenditure incurred by a company associated with the participator. The definition of associated company for this purpose is similar to that for exploration and appraisal relief (Appendix III.12), but the relevant period is the period ending on the date of the election and beginning with the claim period in which the expenditure is incurred or, if that is the first claim period of the field of origin, on the date on which any part of the field was determined as a field by the Secretary of State.

Unrelievable field losses

6.11 Where the winning of oil from a taxable field has permanently ceased, and the participator has allowable losses (or would have had if the total amount of oil ever won from the field had been sufficient to bring the charging mechanism into effect) which have not been relieved against profits arising in the same field under the normal loss provisions (Paragraph 4.63), the participator, or a company associated with it, may claim for those losses, including uplift, to be treated as expenditure incurred, at the date of cessation, in any other field. This relief does not apply where a participator seeks to use the unrelievable field loss against a field where that field was acquired by the participator (or its affiliate) after the field giving rise to the loss was accepted as having permanently ceased production. As with other classes of expenditure, a claim must be made and agreed by HMRC before the losses may be deducted.

Section 6
Section 113
FA 84

6.12 Before FA 1995, it had been possible to augment an unrelievable field loss by first claiming, against the abandoned field, reliefs (e.g., E&A relief) from outside the field; when the unrelievable field loss was set off against the claimant field, such E&A reliefs were effectively being taken by that field even though they might not have been available for offset against it under ordinary principles. To the extent that an unrelievable field loss is attributable to non-field expenditure claimed on or after 29 November 1994, the loss must be restricted so as not to include such expenditures. As well as E&A relief, the non-field expenditures in question are:

- abortive exploration expenditure (Appendix III.13);
- research expenditure (Paragraph 6.3);
- other unrelievable field losses, derived from a different abandoned field; and
- cross-field allowance (Paragraph 6.7).

6.13 For claims made on or after 1 May 1995, the previous time limit of six years is removed. Claims can now be made at any time after the decision has been taken that production from the field has permanently ceased.

6.14 Before FA 2001, it had been possible to generate or augment unrelievable field losses through the transfer of field interests to another party and jointly electing to opt out of Schedule 17, FA 1980 (Transfers of interests in oil fields).

Paras. 5 and 6,
Sch 32, FA 2001

6.15 A participator with an interest in a field nearing decommissioning, could transfer part of the whole of its interest to another party and opt out of the Schedule 17, FA 1980 provisions. The new participator would incur a substantial loss on decommissioning which did not need to be offset against previous profits in the field interest. The new participator was able to claim unrelievable field loss in another field. This had the advantage, in certain circumstances, of maximising the value of the oil allowance.

6.16 For transfers of interests in oil fields on or after 7 March 2001, the unrelievable field losses claim available to the new participator is restricted to the amount that would have been available if no transfer had taken place.

Chapter 7

Oil allowance

7.1 The oil allowance applies in any chargeable period in which a profit remains after deducting allowable losses from the assessable profits of a participator. It is not calculated where there would not otherwise be a chargeable profit.

Section 8

7.2 For fields which first received development approval before 1 April 1982, the oil allowance is 250,000 metric tonnes for each field for each chargeable period, subject to an overall limit of 5m metric tonnes for each field. For fields which first received development approval after 31 March 1982, the oil allowance is 500,000 metric tonnes per chargeable period (with a cumulative limit of 10m metric tonnes) for offshore fields wholly outside the southern basin of the North Sea, and 125,000 metric tonnes (with a cumulative limit of 2.5m metric tonnes) for southern basin and onshore fields. Consent for well tests not involving permanent works is not treated as development approval for this purpose. A new field which includes an area previously included in another field in a determination made before 1 April 1982 will qualify for the increased (or reduced) allowance. The southern basin is any area off the east coast of England south of 55°N and north of 52°N.

Section 36
FA 83
Section 138
FA 88

7.3 Where the oil allowance is used in full for each chargeable period, it will thus be available for ten years. Where the full allowance is not used in a particular chargeable period, it may be carried forward, but, since the limit per chargeable period still applies to each such period, it will only be possible to make use of the whole of the oil allowance if production continues beyond ten years.

7.4 For periods up to 31 December 1978 the limit was 500,000 long tons. Where fields made use of this allowance, it goes against the overall limit of 5m metric tonnes.

7.5 The allowance given to each participator is the cash equivalent of his share of the oil allowance. The oil allowance is divided either on a field equity basis or in the same proportions as the share of oil won and saved from the field in a period as agreed between the partners, and the cash equivalent is calculated in

Section 8(1)-(3)

accordance with the following formula:

$$\left(A \times \frac{B}{C}\right)$$

where A = gross profit of participator (if nil or loss, take as nil)
B = participator's share of allowance, in metric tonnes
C = participator's share of oil except excluded gas, in metric tonnes

Section 8(4)

7.6 Where a participator receives both oil and gas (other than excluded gas), he may elect in any chargeable period to have the calculation made principally in oil, so that it is made by reference to gas only to the extent that his share of oil allowance exceeds his share of oil other than gas.

Section 8(1) & (5)

7.7 The profit from the field is reduced by the cash equivalent calculated in the manner described above, or to nil if the cash equivalent is greater than the profit. In the latter case, the oil allowance will not have been fully used and the actual amount used must be reconverted to metric tonnes.

This reconversion is calculated in accordance with the following formula:

$$\left(X \times \frac{Y}{Z}\right) \text{ metric tonnes}$$

where X = participator's share of oil allowance for the period in metric tonnes
Y = chargeable profit before allowance in £s
Z = cash equivalent of participator's share of oil allowance in £s.

Section 8(6)

7.8 In calculating the utilisation of the total allowance for each field the aggregate oil allowance utilised by each participator in each chargeable period is first determined, and the allowance is then restricted in the chargeable period in which the cumulative total would exceed the field limit.

7.9 It should be noted that, although the allowance is calculated for each participator, the limit is computed on the basis of the whole field. It is quite possible that the utilisation by individual participators will differ. For example, one may have exploration or appraisal expenditure but another will not. In such circumstances the oil allowance will have been shared in unequal amounts. Where this is the case the responsible person is allowed to notify HMRC of the way in which the restriction is to be shared.

Section 66 FA 87

7.10 Where the remaining allowance due for the final period is insufficient to permit such imbalances to be rectified, the responsible person may give notice of a proposed apportionment of the allowance for both the two final periods. The apportionment must be designed to achieve, so far as practicable, a cumulative sharing of oil allowance which is proportionate to the participators' shares of oil won and saved. The proposed allocation need not relate to all of the participators in the field. There is a right of appeal against rejection of the proposal by HMRC.[1]

Para. 10 Sch. 3

7.11 Where an election to spread expenditure forward has been made (Paragraphs 5.32-5.36), the participator's share of the oil allowance may not be increased above the amount it would have been if no election had been made. Where the election reduces the oil allowance, a participator may elect to utilise the difference in any subsequent chargeable period but not in the chargeable period where the reduction occurs.

Para. 11 Sch. 3

7.12 In order to prevent participators from taking advantage of the allowance by delaying claims for expenditure until periods in which profits are sufficient to utilise the full allowance, it is provided that, if a Schedule 5 or Schedule 6 claim (Paragraph 5.2) for a particular claim period is made more than 12 months after the end of that period, HMRC may direct that the oil allowance is to be computed as if a claim had been made and allowed 12 months after the end of the claim period in which the expenditure was incurred.

7.13 In addition, HMRC has sought to restrict the advantage derived by taxpayers by delaying raising assessments until expenditure has been claimed and allowed. The decision in Amoco (UK) Exploration Co. v. CIR [1983] STC 634 confirmed that HMRC has six years from the end of each chargeable period in which to raise an assessment.

7.14 Whilst the anti-avoidance provisions referred to above limit the scope for manoeuvre, it should be noted that in appropriate cases oil allowance may be maximised by the careful timing of claims other than under Schedule 5 or Schedule 6 – e.g., for unrelievable field losses, abortive exploration expenditure and E&A expenditure.

[1] This rule has effect where the final chargeable period of oil allowance ends on 30 June 1987 or later. The time limit for making an apportionment proposal is six months after the end of the final period of oil allowance.

Chapter 8

Safeguard

Section 9

8.1 The purpose of safeguard is to provide a form of marginal relief which will benefit less profitable fields regardless of size. It is not a deduction from assessable profits and is calculated entirely separately. Where the result of this calculation shows a figure of tax payable less than that calculated in the normal way, payment is limited to this amount. The calculation is computed by reference to chargeable period.

Section 9(1)

8.2 Where safeguard applies, the total tax payable by a participator for a chargeable period is limited to 80 percent of the amount by which his adjusted profit for that period exceeds 15 percent of his accumulated capital expenditure qualifying for uplift at the end of that period. The calculation may be illustrated as follows:

	£	£
Adjusted profit		A
Accumulated capital expenditure to end of period	B	
Deduct 15% thereof		(C)
	D	
80% of £D is safeguard PRT		E

Section 9(2)

8.3 The adjusted profit for a chargeable period is the sum of:

	£
The assessable profit or allowable loss (without any reduction for losses from other periods or for the oil allowance)	A
Expenditure of the following kinds deducted in arriving at the assessable profit:	
(a) expenditure qualifying for uplift together with uplift	B
(b) E&A expenditure	C
(c) abortive exploration expenditure	D
(d) research expenditure	E
(e) cross-field expenditure	F
(f) unrelievable field losses	G
Adjusted profit/loss	H

8.4 Accumulated capital expenditure at the end of a period is the total expenditure taken into account for that or previous periods which qualified for uplift. For this purpose, any capital expenditure which has been spread forward by election is included as if the election had not been made (Paragraphs 5.32-5.36).

Section 9(3) & (4)

8.5 Safeguard applies only to periods up to and including the net profit period, as defined for uplift (or the later period to the end of which uplift runs in the case of temporary loss of profitability), together with half as many chargeable periods again. A fraction is regarded as a whole period. For taxable fields the number of periods on which this additional 50 percent is computed excludes any during which the oil won and saved did not exceed 1,000 metric tonnes.

Section 9(1A)
Section 91(1) FA 85

8.6 In a period in which safeguard applies to limit tax payable, no tax will be saved by losses brought forward or carried back or by set-off of unrelievable field losses, abortive exploration expenditure, E&A expenditure, research expenditure or cross-field allowance except to the extent that these reliefs reduce the unsafeguarded PRT liability to less than the safeguarded liability. Accordingly, to the extent that there is choice in their use, they should normally be directed to periods when safeguard does not apply. Where oil allowance is due under the normal rules it is actually used, even if tax payable is limited by safeguard.

8.7 For periods in which safeguard applies it can also be advantageous to defer claiming relief for field expenditure until a later period. HMRC could seek to counteract this advantage by exercising its choice over the timing of assessments. However, it confirmed that in these special circumstances it will not use this power to defer assessments from payback for periods where safeguard relief reduces or cancels any PRT liability. This decision in relation to safeguard has no application to the timing of assessments in other circumstances.

Chapter 9

Payment of PRT

Para. 13 Sch. 2

9.1 The provisions for payment of PRT are complex. PRT is nominally payable six months after the end of the chargeable period (although interest runs from two months after) or, if later, 30 days after the issue of the assessment. In practice, most (if not all) of the tax then due will probably have been paid by means of instalments, during and after the chargeable period, as adjusted in a formal payment on account made two months after the end of the period.

PRT

Section 1 PRTA 80 Para. 15 & 16 Sch.2

9.2 A statement of payment on account (form PRT 6) is required two months after the end of each chargeable period together with a payment of the amount of PRT calculated as due. For example, if the chargeable period ends on 31 December, payment is due on the following 1 March. Interest runs from this day on any overpayment or underpayment of PRT even though the assessment may not be made until later.

Para. 2 Sch. PRTA 80

9.3 The amount of the payment on account is computed following the format of the anticipated assessment for the chargeable period assuming that:

- the tax value of oil production is as shown in the participator's return;
- royalties paid and repaid and period payments to or by the Secretary of State in respect of the licence during the chargeable period are as shown in the participator's return;
- the five percent of gross profit allowance and clawback is ignored;
- *expenditure and uplift claimed but not at that time allowed is allowed and shared as claimed (the taxpayer need not take account of all such expenditure if he does not so wish – for example, if it were to produce a loss);
- *abortive exploration expenditure, E&A expenditure, research expenditure and unrelievable field losses claimed but not at that time allowed are allowed as claimed.

* This expenditure may not be so treated for more than one chargeable period or more than one field.

9.4 Relief for agreed PRT losses brought forward and the oil allowance may be assumed.

Para. 3 Sch. PRTA 80

9.5 Safeguard applies based on the assumed figures. Where it is assumed that expenditure is allowed with uplift for the general calculation, that amount is also treated as allowed with uplift for the safeguard calculation.

Para. 4 Sch. PRTA 80

9.6 Subsequently a PRT assessment of profit or determination of loss will be made by HMRC. If the payment on account falls short of the assessed amount, any further PRT becomes payable as outlined in Paragraph 9.1. Where the payment on account exceeds the PRT due repayment will be made in due course.

Section 1(3) PRTA 80

Instalments of PRT

9.7 Where PRT is payable for a chargeable period, instalments of PRT are payable monthly from the end of the second month of the next chargeable period for six months, and are treated as instalments of the PRT liability for the next chargeable period. The instalments are 1⁄8th of the payment on account of PRT for the preceding period, as computed on the participator's form PRT 6 (Paragraph 9.2). The instalment payments are set off against the liability to make a PRT payment on account two months after the end of a chargeable period – i.e., in the next PRT 6 return. If excess payments have been made there will be a repayment.

Paras. 2 & 9(2) Sch. 19 FA 82

9.8 If there is a month in which a participator does not make any deliveries of oil he need not, on giving notice on form PRT 25 to HMRC, make an instalment payment of PRT in the succeeding month. By concession, a participator is also entitled, again on giving notice to HMRC, to withhold the instalment for a month if, in the previous or an earlier month, oil actually ceased to be won from the field as a result of some sudden catastrophic loss of or damage to production, transportation or initial treatment facilities relating to the field, and has not recommenced. For chargeable periods ending on or after 31 December 1999, PRT instalments may not be withheld if the participator receives chargeable tariff income in that month.

Para. 3 Sch. 19 FA 82

9.9 It should be noted that interest will run on instalments paid after the end of the month in which they are due, whether or not the assessment subsequently made for the period shows any actual PRT liability. If the instalment continues unpaid, interest on it will run up to the date, two months after the end of the

Para. 10 Sch. 19 FA 82

period, when the payment on account is due (Paragraph 9.2); at this point, if appropriate, the ordinary provisions for interest on late payments of PRT will come into play. Interest on overpaid instalments does not start to accrue until the later of two months after the chargeable period and the date of payment.

Sch. 53 FA 2009
Sch. 9 FB (No.2) 2010
Sch. 55 and 56 FA 2009

Overall, there have been a number of changes to the rules on interest for under and overpaid PRT in recent years and the penalty regime generally.

Section 302
CTA 2010

Interest on overdue or overpaid tax

9.10 Interest paid or received in respect of overdue or overpaid PRT is neither deductible nor taxable for CT purposes. The rate, which takes account of the tax treatment, now follows movements in commercial rates rather more closely than in the past. Interest harmonisation proposals may align the interest rates on PRT with rates used for CT.

Para. 17
Sch. 2

Interest cap on PRT repayments

9.11 Where a PRT field loss (Paragraph 4.63) arises in a chargeable period ending after 30 June 1991, and this loss is carried back and results in a PRT repayment for an earlier period, there is a cap on the interest attaching to the repayment. This is not to exceed the difference between:

(a) 60 percent of the loss in question (formerly 85 percent, where the period of loss ends on or before 30 June 1993); and

(b) the amount of the PRT repaid.

Repayment plus interest cannot therefore exceed 60 percent of the gross amount of the loss. This provision addresses the government’s concern at the interest cost that would otherwise have arisen from the significant repayments expected to be generated by abandonment losses. Clarification of computational aspects of the working of the cap is provided by the case of Elf Enterprise Caledonia Ltd v. CIR [1994] STC 785.

Certificates of tax deposit

9.12 Certificates of tax deposit may be used to discharge any of the payments discussed in this chapter.

Chapter 10

Administration of PRT

10.1 The administrative provisions governing PRT are generally stronger than those relating to CT. They are designed to facilitate speedy collection of tax and to prevent any delay. To this end a complicated system of returns, statements and due dates is prescribed. These are outlined below.

Responsible person for each field

10.2 The participators in a taxable field must nominate a UK resident body corporate or partnership to act as the responsible person, though the appointment is actually made by the Board of HMRC. In practice it is normal for the operator to be so appointed.

Para. 4 Sch. 2

Returns by responsible person

10.3 The responsible person must return information on a taxable field to the Board of HMRC within one month of the end of each chargeable period (Form PRT 2). The Board of HMRC may allow a longer period for the submission of the return. However, an application to defer will only be available if certain criteria are met. The information required relates primarily to quantities and shares of oil.

Paras. 5 & 6 Sch. 2

10.4 In general the responsible person is also required to lodge claims for the allowance of expenditure (Paragraphs 10.15 et seq).

Returns by participators

Nomination of proposed transactions

10.5 Nominations of proposed transactions in accordance with the Nomination Scheme (Paragraph 4.29) are made by individual participators.

Participator's return

Para. 2 Sch. 2
Section 62
FA 87
Para. 2(2A)
Sch. 2

10.6 Every participator must return information (Form PRT 1) as to prices, market values, royalties, etc, relating to its share of oil from a taxable field within two months of the end of each chargeable period. Additional particulars are required of sales of Category 2. Each participator must also return information on tariff receipts and disposal receipts for each chargeable period. For the first chargeable period of a taxable field, each participator must make a return of field exploration and appraisal expenditure previously claimed by him, or by a company associated with him (or by a predecessor if he has acquired his interest by a field transfer), against any other field.

Statement of payment on account of PRT

Section 1
PRTA 80

10.7 This (Form PRT 6) is required at the same time as the participator's return (Paragraph 9.2).

Fields not likely to have to pay PRT

Para. 5(4),
Sch. 2

10.8 For chargeable periods ending on or after 30 June 1999, the time limits for filing the following returns can, subject to prior agreement with HMRC, be deferred indefinitely or for a specified period of time:

- Form PRT 1 (Paragraph 10.7)
- Form PRT 2 (Paragraph 10.4)

However, form PRT 1A will still be required to be filed within two months of the end of each chargeable period, and must include all sales of oil made during the chargeable period.

Other items

10.9 In certain circumstances the participator is also responsible for lodging claims for field expenditure undertaken by himself (Paragraph 10.15). The participator is also responsible for making claims for the allowance of E&A expenditure (Form PRT 60A), abortive exploration expenditure (Form PRT 60), research expenditure (PRT 60B), cross-field allowance and unrelievable field losses (PRT 65) (Paragraphs 10.33-10.41).
Additionally, there are claims for:

- spreading elections (Paragraph 5.32);
- calculation of oil allowance if more than one type of oil is won for PRT (Paragraph 7.6);
- royalty holder's oil sold at arm's length (Paragraph 3.8).

Assessment to PRT and determination of loss

Paras. 10-12 Sch. 2

10.10 Where the Board of HMRC is satisfied with the returns and claims made by the participator and responsible person, the assessment to PRT or determination of loss is made in accordance with the returns and claims. Any expenditure claims allowed since the last assessment to PRT or determination of loss was made are also to be taken into account.

If the Board is not satisfied with the returns and claims, or a return is not made, an assessment will be made to the best of its judgment.

Para. 14, Sch. 2

10.11 A participator may appeal in writing, to the Tribunal (previously the Special Commissioners) against an assessment or determination within 30 days of its issue. Otherwise it becomes final. The Tribunal may alter the assessment in any way and there is no appeal from their decision on a point of fact, although an appeal may be made to the courts, by either party, on a point of law. There are detailed provisions relating to the withholding of tax where an appeal is made, but generally postponement of tax applies only to appeals on valuations of oil. Administration of PRT.

Information powers

Section 115 & 116, FA 84

10.12 The Board of HMRC has information powers, apart from those referred to in Paragraph 10.7, for the purpose of determining whether disposals are at arm's length, or for ascertaining market values where oil sales involve associated companies. These powers complement those which it has for corporation tax purposes. Notice may be given to a UK-resident company to supply information which it or any of its 51 percent subsidiaries possesses. Appeal is available to the Tribunal if the Board of HMRC refuses to direct that a company need not comply with these requirements as regards one of its non-UK resident 51 percent subsidiaries. Penalties may also be imposed in certain circumstances.

Section 187 FA 93

10.13 The Board of HMRC can require any person to provide such information as the Board thinks relevant to the determination of a tax liability. These provisions supplement earlier provisions which related only to failures to make returns. They are widely drawn and similar to provisions already in place for corporation tax purposes.

Allowance of field expenditure

10.14 Expenditure may only be deducted as part of the amount credited or debited in respect of expenditure if claims have been submitted to and agreed by HMRC in accordance with Schedule 5 (claims by responsible persons – Form PRT 30) or Schedule 6 (claims by participators – Form PRT 40).[1]

10.15 For the distinction between claims by responsible persons and by participators, see Paragraph 5.2. The statutory references below are those applying to claims by the responsible person. Similar provisions in Schedule 6 apply to claims by participators.

Claim periods and claims

10.16 Claims are made on the basis of claim periods. The first claim period is that ending at the end of June or December following the determination of the field, at the option of the responsible person. Each subsequent claim period is six or 12 months, again at the option of the responsible person. If no election is made, the claim period will automatically be 12 months. Expenditure must be included in a claim for the period in which it is actually incurred. However, more than one claim may be submitted, and claims for field expenditure can be made up to six years after the end of the period in which the expenditure is incurred.[2]

10.17 Relief will be given for the expenditure in the next assessment made after HMRC has notified its decision that the expenditure is allowed (Paragraph 10.25). In general it is therefore to the taxpayer's advantage to submit claims as quickly as possible; this will result in earlier allowance for the relevant expenditure. The facility to submit more than one claim for particular periods is of assistance in that difficulties in ascertaining the amount of certain expenditure need not delay the claim for the rest.

10.18 For field expenditure claims received by HMRC after 16 March 1993, and allowed, the expenditure cannot be deducted in an assessment for a period earlier than the one in which the expenditure was incurred.

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[1] In order to avoid undue delay, HMRC may accept provisional claims for expenditure before fields have been formally determined.

[2] This provision was designed to prevent manipulation at the time of the reduction in the rate of PRT from 1 July 1993.

10.19 Where long-term assets are concerned and the assets are not such that the whole costs would be allowed in the first relevant period, it would not be possible to submit claims until the expiry of the claim period.

10.20 Where full details relating to such long-term assets are not submitted within 12 months of the end of a claim period, HMRC may proceed to the best of its judgment.

10.21 Where a claim involves expenditure by a person before becoming a participator, that expenditure should be included in the claim for the claim period in which the person becomes a participator.

Para. 2(4) Sch. 5

10.22 HMRC accepts (letter of 6 March 1996) that a claim or part of a claim may be withdrawn at any time before a decision has been taken (Paragraphs 10.25-10.26) in respect of the expenditure in question. HMRC accepts (letter of 6 March 1996) that a claim or part of a claim may be withdrawn at any time before a decision has been taken (Paragraphs 10.25-10.26) in respect of the expenditure in question.

Contents of claim

10.23 In addition to details of actual expenditure, the claim must state:

Para. 2(5) Sch. 5

(a) what part of expenditure is claimed as qualifying for uplift;

(b) the share of expenditure and uplift allocated to each participator (for ways in which this may be shared, see Paragraph 5.2);

(c) such information as is necessary to enable adjustments to be made in respect of certain long-term assets in periods subsequent to the first claim period.

Decision on claims

10.24 HMRC must give written notice of its decision on each claim and must state:

Para. 3(1) Sch. 5

(a) the amount of expenditure allowed;

(b) the amount of expenditure allowed which qualifies for uplift;

(c) the share of allowed expenditure and uplift allocated to each participator.

10.25 HMRC may make a decision on part of a claim, leaving the balance to be determined later. There are no provisions obliging it to make a decision within a given time from the submission of a claim and, since expenditure is not allowed until agreed, unreasonable delay could be detrimental to the taxpayer. However, in order to protect the taxpayer's right of appeal (Paragraph 10.27) HMRC will in practice make decisions on the whole of the claim within two years and nine months of the date on which the claim is made.

Appeals

Para. 5(1) Sch. 5

10.26 Where a claim is not allowed in full or the proportions in which it is shared are varied, an appeal may be made to the Tribunal. It may be made not more than three years after the making of the claim.

Para. 5(4) Sch. 5

10.27 The Tribunal may vary the decision appealed against in any way. Thereafter an appeal may be made to the courts but on a point of law only.

10.28 The decision appealed against remains in force without alteration until the appeal is determined. An appeal may be determined by:

(a) abandonment by the responsible person; or

(b) agreement with HMRC; or

(c) determination by the Tribunal.

If the determination of the Tribunal is varied on appeal to the courts, appropriate adjustments are to be made.

Para. 8 Sch. 5

10.29 Where disputed expenditure is allowed on appeal, it is treated as having been allowed on the date upon which notice of appeal was given and not on the date from which the original claim was agreed in whole or in part by HMRC. Where the appeal relates to the proportion in which expenditure is shared, the decision relates back to the date on which the relevant expenditure is allowed or treated as allowed.

Variation of decisions

Para. 9 Sch. 5

10.30 Where it appears to the Board of HMRC that a claim has been incorrectly allowed in any respect, it may vary its decision within three years of giving it. In such cases the variation is given effect by retrospectively amending assessments or loss determinations to the amount that would have applied if the original decision had been correct.

The taxpayer may appeal against a variation to the Tribunal under rules similar to those applying for claims.

10.31 In cases where the variation is made because there was an over-allowance wholly or partly attributable to fraud or neglect, the three-year time limit is removed, and the variation may be made at any time.

Para 9 (1A, 1B, 1C)
Sch. 5

Allowance of E&A expenditure, research expenditure or abortive exploration expenditure

10.32 A claim for E&A expenditure, abortive exploration expenditure or research expenditure is to be made by the participator. There is no time limit for such a claim.

Sch. 7

10.33 E&A expenditure incurred after the end of a chargeable period could formerly be taken into account in the assessment for that period, provided a claim had been submitted to and agreed by HMRC before that assessment was raised.[3]

Section 192(2)
FA 93

10.34 Appeal procedures are similar to those for field expenditure (Paragraphs 10.27-10.30).

Variation of decisions

10.35 Since 16 March 1987 it has been possible to vary claims made under Schedule 7 (claims for abortive exploration, E&A and research relief).

Section 67
FA 87
Section 122
FA 90

Allowance of cross-field expenditure

10.36 An election for cross-field allowance is to be made by the participator and is irrevocable. In no case can the cumulative amount of cross-field allowance exceed 10 percent of the qualifying expenditure (Paragraph 5.17) but, subject to this, more than one election may be made in respect of the same expenditure and in respect of one or more of the participator's receiving fields. Where more than one such field is specified in a single election, that election must specify how the allowance is to be apportioned.

Section 65 &
Sch. 14
FA 87

10.37 The election cannot be made until a final decision has been made that the expenditure in question qualifies for uplift. That may happen either when HMRC

[3] Expenditure incurred after 31 March 1993 cannot be deducted in an assessment for a chargeable period ending before the date on which the expenditure was incurred.

gives notice of its decision allowing the uplift claim or, following refusal of the claim, allowance is agreed on appeal or the claim is upheld by the Tribunal or the courts. In the event of a successful appeal the cross-field allowance may be given retrospective effect.

10.38 An election in respect of particular expenditure must be made before HMRC makes an assessment to tax or determination of loss for the field of origin, taking the expenditure and uplift into account, and issues the notice of assessment or determination.

Allowance of unrelievable field losses

Paras. 1 & 2, Sch. 8

10.39 When it appears to the responsible person that the winning of oil from a field has permanently ceased, he may refer the matter to the Board of HMRC. The Board must notify the responsible person of its decision together with the date from which it is satisfied that the winning of oil has permanently ceased.

Para. 3, Sch. 8

10.40 There is no time limit within which the Board must give its decision, but if the decision is unfavourable the responsible person may appeal to the Tribunal within three months of receiving notice of that decision. The responsible person must give a copy of the Board's decision to each participator including past participators, within one month of receiving it. Once a date of cessation has been finally determined, claims for relief may be made by the individual participators within specified time limits.

Senior Accounting Officer (SAO) regime

10.42 With effect from financial years beginning on or after 21 July 2009, SAOs of qualifying companies (broadly 'large') will be required to take reasonable steps to establish and monitor adequate accounting systems for the purposes of accurate tax reporting. They will also be required to certify annually that the systems are adequate, or otherwise specify the nature of any inadequacies. This regime covers several taxes including PRT.

Part 3 Corporation Tax

Chapter 11

Corporation tax for oil producers

11.1 Oil-producing companies are subject to normal UK taxation rules, but with a number of modifications as discussed below. It should be noted that UK companies with foreign branches are taxed on a worldwide basis with credit relief for overseas tax. The government is currently considering amending the foreign branch rules with a possible move to an exemption system.

Commencement of trading

11.2 The commencement of trading is significant for UK tax purposes because no tax relief can be obtained for expenditure until that time.

Section 61 CTA 10

11.3 The date on which trading commences is a matter of fact so far as oil production operations are concerned. HMRC has stated, following a 1967 agreement with the UK Oil Industry Taxation Committee (UKOITC), that the date upon which the decision is taken by a company to develop its first oil field for commercial production may be regarded as the date on which the trade of oil production commences or when contracts to sell future oil are put in place, if earlier. Although these principles have been published only in relation to UK licences, HMRC generally applies similar procedures to foreign licences. The taxpayer may choose to take the actual date of commencement of trading if he prefers. This would generally be when production commences. Where the taxpayer is a joint licensee, HMRC will look for evidence of a consortium decision to develop an oil field in establishing the trade date and will wish the same date to be applied to all consortium members. They would not normally be willing to accept that such a decision is capable of being made until it is reasonably evident that the consortium will obtain the DTI's consent for the implementation of development, and the occasion of the Department's formal approval of the development consent is generally identified as the final trigger for the commencement of the trade. It should be noted however that a trade may in fact have commenced earlier than that date.

11.4 Election for an early trade date is desirable where it is intended to use field development losses against other income of the company or within the UK tax group by way of group relief.

Section 161 & 401
CAA 2001

11.5 Pre-trading expenditure which qualifies for capital allowances will be treated for tax purposes as if incurred on the first day of trading, and relief will therefore become available at that date. HMRC requires that expenditure incurred in a currency other than sterling be converted at (and allowance be computed by reference to) the rate ruling when the expenditure was actually incurred and not at the later date of commencement of trading. However, see Paragraph 11.50) for the rules in relation to non-sterling functional currency.

Section 61
CTA 09

11.6 Revenue expenditure incurred in the seven years before commencement of trading wholly and exclusively for the purposes of the trade will also be treated as if incurred on the first day of trading and become allowable then.[1]

11.7 The treatment of pre-trading interest expense changed with the introduction of the corporate debt rules in FA 1996 (now in CTA 09). With effect from 1 April 1996, pre-trading interest is to be treated as a non-trading debit.

Section 330 & Chapter 16
CTA 09

11.8 Such non-trading debits may be set off against other income under the normal rules applicable to the offset of non-trading debits. Thus, very broadly, they may be relieved against other profits of the accounting period, by group relief, by carry back against profits of earlier accounting periods and by carry forward against non-trading profits – including capital gains – of future accounting periods.

11.9 This alters the previous ability to carry forward pre-trading interest to offset against trading income on the commencement of trade. Therefore, an election may be made to set aside non-trading debit treatment in certain circumstances where this is favourable. The election must be made within two years of the end of the accounting period in which the non-trading debit arose. If it is made, and:

- the company begins to carry on a trade within the period of seven years beginning with the end of the accounting period in which the non-trading debit (pre-trading interest) arises; and

[1] The period is limited to five years where the trade commenced before 1 April 1993, and three years where it commenced before 1 April 1989.

- the interest is such that if incurred during the period in which the trade begins to be carried on, it would have been treated as a trading debit (i.e., trading expense); then that debit may be brought into account as a trading debit for the accounting period in which the trade is first carried on.

Relief for charges on income and interest expense

11.10 Following the rules introduced in FA 1996 (now in CTA 09), interest can no longer be a charge on income. However, subject to the provisions of section 1301 CTA 09, charges on income may still include such items as royalties. Subject to the special ring fence restrictions described in Paragraphs 11.39-11.43, charges on income are allowed as a deduction against the total profits of a company, and not in computing the profits of its trade. Licence fees payable to the DTI, however, are treated as a business expense.

11.11 For the purposes of obtaining a deduction against profits for corporation tax purposes, no distinction is made between different types of interest payment (eg, bank interest, short interest and annual interest).

Section 295
CTA 09

11.12 Broadly, interest incurred in respect of loans entered into for the purposes of a company's trade will be deductible as an expense of that trade. All other interest will be regarded as being for a non-trade purpose with separate rules for relief (Paragraph 11.8). To obtain a deduction for interest as an expense of a ring fence trade further tests must be met (Paragraph 11.24).

Sections 297-301
CTA 09

11.13 Where the financing arrangement is between related parties and is not on an arm's length basis, the profits (or losses) may be compared as if the transaction had been on an arm's length basis. Encompassed within the new transfer pricing rules are the rules on thin capitalisation. These substantially replace the old UK thin capitalisation rules.

Part 4
TIOPA 10
Sections 444-446
CTA 09

11.14 Where questions arise as to the level of debt when considering the transfer pricing rules there is no 'safe haven' or similar rules in the UK to give comfort on the level of gearing which HMRC will find acceptable. As a rule of thumb, HMRC will generally take the view that any company with a debt to equity ratio higher than 1:1 is prima facie thinly capitalised. In such a case they will then move on to consider the projected level of profits available to service the borrowing and any other evidence of the amount that a commercial lender at arm's length would have been prepared to lend. In the case of a non-recourse field development loan, for example, they may have a view on the percentage of the discounted net present value of the field which a lender would be prepared to advance.

Part 6
TIOPA 10
Section 441
CTA 09
Section 522
CTA 09

They will always contend that these provisions will deny to companies in the exploration stage any deduction for intercompany interest paid. It should be noted that there are a variety of rules/anti-avoidance measures that may restrict or deny interest deductions, in addition to transfer pricing. The details of such rules are outside the scope of this book but they include:

- the "arbitrage rules" which effectively deny a double dip in certain scenarios;
- the "disallowable purpose" rules which deny a deduction for interest on a loan taken out for disallowable purposes;
- the "shares as debt" rules, whereby certain shares which produce an "interest-like" return are treated as if the income they generate is interest, and not a distribution/dividend, in the hands of the shareholder (only).

Section 486A
CTA 09

However, with effect from 22 April 2009, the "shares as debt" rules are effectively replaced by "disguised interest" rules. These rules seek to ensure that an "interest-like return" is charged to tax as such, when it does not arise from a loan.

Part 7
TIOPA 10

The "worldwide debt cap" rules which seek to ensure that overall a (large) group cannot claim more interest deductions in the UK than the consolidated financing costs of the worldwide group. These rules apply for accounting periods beginning on or after 1 January 2010. However, there are special ring fence rules which mean that ring fence loans are excluded from the calculations.

Derivatives

Part 7
CTA 09

11.5 FA 2002 introduced new rules for derivative contracts for accounting periods beginning on or after 1 October 2002 (now contained in Part 7 CTA 09). Prior to their introduction derivative contracts in respect of forward oil sales, for example, were subject to tax under general principles.

11.16 The general rule is that profits made by a company from derivative contracts are taxable as income, as opposed to capital.

Section 576
CTA 09

11.17 Broadly, a derivative is a financial instrument whose performance is based on the movement of the price of an underlying asset and includes an option, a future or a contract for differences.

11.18 A contract is prevented from being treated as a derivative contract if its underlying subject matter relates to excluded types of property (e.g., options or futures over intangible fixed assets).

11.19 The computation of profits under the derivative contracts rules are based on debits and credits similar to the loan relationship rules. The amounts brought to account are based on generally accepted accounting practice. However, where amounts are capitalised such amounts are treated as giving rise to debits and credits in the period in which they are brought into account in determining the company's profit and loss for that period.

Chapter 3 Part 7
CTA 09

11.20 The relevant debits and credits are treated as receipts or expenses of the trade if the company entered into the contract for the purposes of its trade. However, where the derivative contract was not entered into for the purposes of a trade, the rules under the loan relationships provisions shall apply as if the amounts were non-trading credits or non-trading debits. In practice, HMRC will usually accept that where derivative contracts are taken out to hedge equity production, the contract will have been entered into for the purposes of the trade and therefore potentially inside the company's ring fence.

11.21 Since there are differences in the treatment of hedging contracts under international accounting standards and UK GAAP, regulations operate to disregard for tax purposes the changes in fair value of certain hedging contracts when recognised in the accounts and instead tax such amounts at a later date (e.g., upon maturity or on disposal of the contract). A company may, however, elect out of these regulations within specified time limits such that the changes in fair value are brought into account for tax purposes.

SI 2004/3256

11.22 Detailed discussion of these provisions is beyond the scope of this book.

Abandonment costs

11.23 The treatment of abandonment expenditure is discussed in Chapter 13.

Ring fence provisions

11.24 Under the normal corporation tax (CT) rules, trading losses, capital allowances and associated losses may be relieved in a number of different ways. Very broadly the options are as follows:

Chapter 2 Part 8
CTA 10

(a) against all other profits of any kind of the company for the same accounting period and for accounting periods falling wholly or partly within the 12 months immediately preceding the accounting period of loss (3 years on the cessation of trade); or

(b) against the profits of any companies within the same UK group or consortium arising in the same accounting period; or

(c) against the future income of the trade giving rise to the loss.

11.25 The purpose of the ring fence provisions is to prevent the dilution of the tax payable on the exploitation of UK oil and gas by prohibiting the offset of losses arising from all other activities against profits arising from:

(a) oil extraction activities;

(b) the acquisition, enjoyment or exploitation of oil rights.

Section 272 CTA 10

11.26 Oil extraction activities are any activities in:

(a) searching for oil in the UK or Continental Shelf; or

(b) extracting oil in the UK or Continental Shelf; or

(c) transporting oil extracted offshore to the UK (or to another country) under oil rights held by the person carrying out the activities; or

(d) effecting initial treatment or storage of oil won under oil rights held by the taxpayer. Oil rights means rights to oil to be extracted in any place in the UK or the Continental Shelf, or to the interests in or to the benefit of such oil.

11.27 It will be seen that the definition in Paragraph 11.26 above embraces all aspects of UK oil production (including tariff and tax exempt tariffing receipts, see Paragraph 4.34) or the holding of UK licence rights, but does not extend to non-UK licences.

11.28 The rules described in more detail below only apply to those activities which will be described hereafter as ‘ring fence activities’. An important feature of the provisions is that the ring fence faces one way only. There is no restriction (beyond the normal CT rules) on the offset of losses arising from ring fence activities against profits arising elsewhere. It should also be noted that the ring fence applies to the whole of the UK and UKCS. There is no field-by-field restriction as is the case with PRT, nor any concept (Paragraph 2.1) of taxable and non-taxable fields.

Capital gains and hold-over relief

11.29 Capital gains arising on the disposal of a field interest, including gains on the associated transfer of assets used in connection with the field, are within the ring fence. The test is that there must be a determined field, and any gains arising on a transfer before final field determination are therefore outside the ring fence. Even where there is a determined field, gains on assets disposed of as part of the field disposal are within the ring fence only if the asset is ‘used in connection with the field’ during the development phase; it is arguable that the platform, pipeline etc under construction are not being ‘used’, so that gains on them at this stage should not be ring fenced.

11.30 Ring fence capital gains and allowable losses arising in a chargeable period are aggregated to produce a single notional gain or loss. In the case of a gain, it is aggregated with ring fence income (if any) of the period to give ring fence profits. An aggregate loss will be carried forward for offset against future ring fence gains but may, if an election is made before the expiry of two years following the period in which the loss arose, be relieved against non-ring fence chargeable gains of the same or future periods.

Section 197 TCGA 1992

11.31 From 1 July 1999, rollover and holdover relief is available in respect of any gain arising on the disposal of the field interest (Paragraph 15.10). Where the new assets are used for the purposes of the ring fence trade of the company or another company in the group, a gain on the associated disposal of field assets may be held over against certain categories of newly acquired asset, but only for a maximum period of 10 years, and only if the new assets are used for the purposes of the ring fence trade of the company or another group company. There can be no rebasing to March 1982 value of either the field interest itself or any of the field assets (Paragraphs 14.12-14.13).

Section 198 A-G TCGA 92

11.32 For disposals of ring fence assets from 22 April 2009 reinvestment relief may be available. Where a gain would otherwise have qualified for rollover or holdover relief, the taxpayer may, instead, claim exemption for the gain. Where reinvestment is of less than the total sale proceeds, the relief is reduced by the shortfall (Paragraph 15.30). Where certain licence swaps are undertaken, they may qualify for tax neutral treatment (Paragraphs 15.15 and 15.32).

Ring fence activities – separate trade

11.33 Where a person carries on any of the ring fence activities outlined in Paragraph 11.26 above, they are treated as a separate trade, even if they form only part of a company's trade. Where an otherwise single trade consists partly of ring fence activities and partly of other activities, profits and losses must be calculated separately. In calculating the profits and losses of each of the notional trades, the market value of any relevant appropriations for the purposes of PRT are to be treated as income of the ring fence trade. It follows that this is also to be treated as the cost of purchase of oil in the course of the non-ring fence trade. As a consequence of this provision, a taxable profit on which CT must be paid may well arise in respect of the ring fence trade, even though the oil has not been sold by the company.

Section 279 CTA 10

Section 279
CTA 10

11.34 The statutory definition of oil related activities, which determines the way in which expenditure is to be split between the ring fence and the non-ring fence elements of the trade, is at variance with the basis upon which the oil crossing the ring fence is to be valued (Paragraph 11.48).

Problems arising from this lack of consistency have in some cases been dealt with by negotiation between the members of each field and HMRC. By contrast, specific legislation has been required to deal with similar PRT anomalies. It should be noted that ring fence activities can extend not only to trading income but also to non-trading income. There can be cases where income or expenditure does not fall clearly inside or outside the ring fence. In such cases HMRC is disposed to look for symmetry as regards both receiver and payer.

Restriction on expenditure after a sale and leaseback

Section 288
CTA 10

11.35 Where a sale and leaseback transaction has occurred, the finance charge element of lease rentals will not be allowable for ring fence CT purposes unless the proceeds of the sale of the asset are used to finance North Sea activities. The expenditure disallowed is treated as a non-trading debit in respect of a loan relationship of the lessee for that accounting period, and will therefore be deductible for non-ring fence CT purposes.

Restriction on loss relief within the company

Section 304
CTA 10

11.36 Where losses including capital allowances would normally be relieved against other profits of the company in the manner outlined in Paragraph 11.24 above, it is provided that such relief may only be given against profits arising from ring fence activities to the extent that the losses arise from such activities. Where a ring fence loss is carried forward it may nevertheless be relieved against future income from both the ring fence and the non-ring fence deemed trades.

Section 303
CTA 10

11.37 The management expenses of an investment business may not be set off against ring fence profits. This provision applies with effect from 12 March 2008 with an apportionment provision for straddling accounting periods although it is understood that HMRC believe that this restriction has always applied.

Restriction on group relief

Section 305
CTA 10

11.38 When losses, including capital allowances, would normally be relieved against profits of other companies within a group in the manner outlined in Paragraph 11.24 above, such relief may only be given against profits arising from oil extraction activities to the extent that the losses arise from similar activities.

Restriction on deduction of interest expense

Section 286 CTA 10

11.39 Interest is not allowable as a deduction against profits from ring fence activities, unless it is payable in respect of money borrowed by a company which is shown to have been either:

(a) used to meet expenditure incurred by the company in either:

(i) carrying on oil extraction activities; or

(ii) acquiring oil rights other than from connected persons; or

(b) appropriated to meet such expenditure.

11.40 Where interest is paid to an associated company, it is allowed as a ring fence deduction (if satisfying the above conditions) to the extent that it does not exceed a reasonable commercial rate, having regard to all the terms on which the money was borrowed and the standing of the borrower. In some cases HMRC has sought to deny the deduction where the associated company has not itself incurred interest, or to restrict the deduction to the rate suffered by the associate.

11.41 Interest paid on a loan which is not the original qualifying loan but a replacement for such a loan will not strictly be deductible against ring fence profits. In practice, however, HMRC does not challenge the deduction in a straightforward case, broadly provided the terms and conditions of the new loan are identical to the original.

11.42 It will be appreciated that, in view of the restriction of the deductibility of interest on the acquisition of oil rights to cases other than the acquisition from a connected person (Paragraph 11.39), interest may not in strictness be fully deductible following an internal reconstruction; for instance, where a business is transferred to a different member of a group. In practice relief may be granted, provided no additional advantage is taken.

11.43 Prior to the introduction of the corporate debt rules in 1996, the above restrictions to the deductibility of interest for ring fence purposes applied only to interest which was a charge on income (broadly, non-bank annual interest). The corporate debt rules brought within the scope of these provisions borrowings which may previously have been outside the restrictions (e.g., bank borrowings and loans incapable of exceeding a term of one year). A particular issue arises where a bank carrying on a banking business in the UK lent to fund the purchase of oil rights from a connected party. Whereas interest on

the loan would previously have been an allowable expense (as it was not within the restriction set out by section 286 CTA 10) it is not allowable now as the borrowing falls within section 286 CTA 10 from commencement of FA 1996.

Set-off of ACT after 5 April 1999

11.44 ACT was abolished with effect from 6 April 1999. Surplus ACT accumulated at 6 April 1999 may be utilised in future accounting periods, subject to restrictions under the 'shadow ACT' regime.

11.45 The shadow ACT regime works as follows:

(a) the limit for ACT set-off of 20 percent of corporation tax profits has been retained;

(b) this limit is first used by shadow ACT (which is computed on the same basis and at the same rate as actual ACT but is not payable by the company) and does not result in any reduction in the corporation tax due;

(c) where the amount available for ACT set-off exceeds the shadow ACT, surplus ACT brought forward may be set off up to the amount of the remaining limit and reduces the CT due;

(d) where shadow ACT exceeds the amount available for ACT set-off, the excess shadow ACT is carried forward and restricts ACT set-off in subsequent periods.

Dividends from non-UK residents

Section 931A CTA 09

11.46 Prior to 1 July 2009, companies resident in the UK are subject to tax on dividends from non-UK residents. However, double taxation relief is available under domestic tax laws and international agreements. Developments in EU law cast doubts on the validity of certain aspects of the UK's traditional treatment of dividends paid and received. For dividends/distributions paid on or after 1 July 2009, both UK and non-UK dividends are subject to UK tax in the hands of a UK resident company, unless they are exempt. There are various classes of exemption and they include an exemption, broadly speaking, if:

- the recipient controls the payer (alone or with another person); or
- the dividend is made in respect of ordinary, non-redeemable shares; or
- the recipient holds less than a 10% shareholding (and entitlement to profits) of the payer.

If an exemption does not apply, then double tax relief may be available. A more detailed discussion of these rules are outside the scope of this book.

Deduction of PRT in computing income

Section 299 CTA 10

11.47 PRT paid may be deducted in computing a taxpayer's ring fence income for CT purposes. Relief is given by deducting PRT paid in respect of a chargeable period from ring fence income of the accounting period of the company in which or at the end of which the chargeable period ends. If trading ceases before the end of the chargeable period, relief is still available. If PRT is subsequently repaid, the CT profits will be adjusted accordingly, subject to special rules where the repayment results from the carry back of a field loss (Paragraph 13.9).

Valuation of oil produced in the UK for CT purposes

Section 280-285 CTA 10

11.48 In order to place the valuation of oil for PRT and CT purposes on a consistent basis, the normal CT rules are excluded and the PRT valuation rules are adopted in most cases – including the rules for determining when a sale of oil is made at arm's length (Paragraph 4.4) and how market value is to be computed (Paragraphs 4.9-4.22). The position may be summarised as follows:

(a) Where oil is disposed of at arm's length the sale proceeds are adopted.

(b) Where there is a non arm's length sale and the PRT rules require market value to be adopted, then market value is normally taken.

(c) Where oil is relevantly appropriated for PRT purposes, it is to be treated as having been disposed of in the course of a separate trade of oil extraction activities, and reacquired in the course of another trade, in both cases at the valuation used for PRT purposes.

(d) Where there is a non arm's length sale or a relevant appropriation which does not fall within the PRT rules, then the same consequences shall follow (as under (b) and (c) above) as if it did. This provision will apply particularly in the case of production from non-taxable fields.

(e) Opening and closing stocks of oil, in so far as they have not been relevantly appropriated, continue to be valued under the normal CT rules (ie, usually at the lower of cost and net realisable value).

From 1 July 2006 any excess amount a participator is obliged to include in PRT gross profit as a consequence of the Nomination Scheme (Paragraph 4.29) forms part of his income for ring fence corporation tax purposes. It is also treated as a deduction in the notional non-ring fence trade of the purchaser. The main practical effect of this provision is to subject this amount to the supplementary charge to corporation tax.

Transactions not at arm's length

11.49 FA 1998 introduced revised transfer pricing legislation to coincide with the introduction of self-assessment for companies. This legislation was further extended in FA 2004 and is discussed in detail in Appendix IV.

Non-sterling functional currency

Section 9
CTA 10

11.50 Over the years there have been several changes to the legislation regarding the currency in which a company must present their corporation tax computations. The rules applicable depend upon the accounting periods in question. A major change was made to the FA 1993 rules by Finance Act 2004 which in turn has been amended several times subsequently.

A detailed explanation of these rules is outside the scope of this book but, very broadly, the various rules have the effect that the computation of a company's profits or losses for tax purposes should be prepared in its functional currency (which may be different from the presentational currency in the accounts), and then be translated into sterling at the appropriate exchange rate to determine the tax liability. The appropriate rate is normally the average rate for a given period or the spot rate for a specific, single transaction.

11.51 Where the supporting financial statements of the permanent establishment of a non-UK resident company are prepared in a non-sterling currency, the profits and losses for tax purposes of that permanent establishment should be computed in that currency and translated to sterling using the appropriate exchange rate.

11.52 There are rules that determine how losses carried forward and back (in the non-sterling currency) are to be translated into sterling, when the losses are set off against the relevant profits. Broadly, the loss is converted to sterling using the same exchange rate as is used to convert the profits they are used against. It should be noted that there are some transitional rules including the ability to make an election for a choice of treatment.

Supplementary charge to corporation tax (SCT)

11.53 Since 24 March 2011 ring fence profits have been subject to a supplementary charge of 32%. The Government announced its intention not to increase the rate further in its Parliamentary term.

11.54 From 17 April 2002, ring fence trade profits were subject to a supplementary charge, initially of 10% and increased to 20% with effect from 1 January 2006.

11.55 Profits are calculated on the same basis as for corporation tax except that financing costs are disallowed. However, the (brief) way the SCT provisions are drafted means there is sometimes a lack of clarity as to how they work in detail. For example, there is uncertainty as to precisely how SCT works in relation to group relief (particularly, in relation to the treatment of disallowed financing costs) and other forms of loss relief. HMRC have updated legislation in Finance Act 2012 to "put beyond doubt" any uncertainty over whether ring fence chargeable gains are subject to SCT with respect to gains arising or crystalising after 6 December 2011.

Section 330 CTA 10

Field Allowances

11.56 For certain new fields authorised for development from 22 April 2009 Field Allowance applies to reduce profit subject to SCT. The allowance is reminiscent of the PRT oil allowance.

Section 333 CTA 10

11.57 The allowances available for each field are as follows:

Small oil field – pre 21 March 2012	£75m for fields with reserves up to 2.75m tonnes, tapering to nil when reserves are 3.5m tonnes
Small oil field – post 21 March 2012	£150m for fields up to 6.25m tonnes, tapering to nil when reserves are 7.0m tonnes
Ultra heavy oil field	£800m for fields with an API gravity below 18 degrees and a viscosity of more than 50 centipoise at reservoir temperature and pressure
Ultra high pressure / high temperature	£800m for fields with a pressure of more than 862 bar and a temperature of more than 176.67 degrees Celsius in the reservoir formation. Where the temperature is between 166 and 176.67 degrees Celsius the field allowance starts at £500m tapering up to £800m
Large deep water gas field	£800m for fields at depths of more than 300m and which are 120km from the nearest gas infrastructure tapering to nil where the pipeline from the field is 60km from existing infrastructure
Large deep water oil field	£3,000m for fields at depths of more than 1,000m with reserves between 25m and 40m tonnes, tapering to nil above 55m tonnes
Large shallow water gas field	£500m for fields at depths of less than 30m with reserves between 10 and 20 billion cubic metres tapering to nil where the field has reserves of 25 billion cubic metres or more

11.58 The allowance is allocated to licensees in equity proportions.

11.59 It may then be activated in any accounting period broadly on the basis of the least of:
(a) 20 per cent per annum of the total allowance;
(b) the company's gross income from the field in the given period; or
(c) the unactivated balance at the beginning of the period.

11.60 The monetary amount thus calculated is then pooled with similar amounts from other fields. The pool is then deducted from SCT profits, any excess being carried forward. There are rules to deal with charges in equity interest and how unactivated amounts are transferred.

11.61 Furthermore, on 7 September 2012 a new Brown Field Allowance was announced in respect of incremental projects approved by DECC from that date. This applies to qualifying projects with capital costs per tonne of incremental reserves expected to be in excess of £60. The allowance is £50 per tonne of expected incremental reserves where the capital cost per tonne is £80 or more. There is a straight-line taper to zero allowance where the capital cost per tonne is £60 per tonne. The field allowance per project is capped at £250m. The cap for projects in fields paying Petroleum Revenue Tax is £500m.

Instalment payments for ring fence profits

SI 1998/3175, Reg 5A

11.62 For accounting periods ending on or before 30 June 2005 CT and supplementary charge due on ring fence profits was payable in quarterly instalments, as under the standard corporation tax rules. For accounting periods ending after 30 June 2005 a different regime applies to the tax liability arising on ring fence profits, with transitional arrangements in place for the first accounting period ending after this date.

11.63 The tax liability arising on ring fence profits is payable in three instalments for periods ending after 30 June 2006 and is based on estimates of the CT and supplementary charge. The due date and amount of each instalment are:

Instalment 1	Due: six months and 13 days from the start of the accounting period. Amount: 1/3 of estimated liability for the period.
Instalment 2	Due: three months from the first instalment due date. Amount: 1/3 of estimated liability for the period.
Instalment 3	Due: 14 days from the end of the accounting period. Amount: balance of estimated liability for the period.

There are provisions in place dealing with instalments where an accounting period is shorter. Tax on any non-ring fence profits is payable in four instalments under the general rules.

Chapter 12

Capital allowances

12.1 Depreciation and amortisation charged in the accounts are replaced by statutory tax depreciation allowances known as capital allowances. In order to place the various forms of allowance in context a chart is set out below which describes the current position.

Oil company ring fence capital allowances

Stage of development		Most favourable allowance
1. Preliminary work	R&DA	100%
2. Acquisition of concession	MEA	10% writing down allowance
3. Exploratory drilling and analysis	R&DA	100%
4. Appraisal drilling	R&DA	100%
5. Development drilling:		
– tangibles	Plant and machinery	100% first year allowance
– well intangibles	MEA	100% first year allowance
6. Installation of production	Plant and machinery	100% first year allowance
7. Production operating costs	Revenue	100% deduction

12.2 Most ring fence capital expenditures may be fully relieved when incurred. For capital allowances purposes, expenditure is taken to be incurred when the obligation to pay becomes unconditional. The date of payment will be used under certain unusual credit circumstances where payment is to be made more than four months after the obligation to pay becomes unconditional. The various types of allowances are discussed below. It is beyond the scope of this book to discuss the rules in detail.

Section 5
CAA 2001

Research and development allowance

12.3 The allowance is 100 percent of expenditure incurred on research and development activities and specifically also to oil and gas exploration and appraisal activities.

Sections 437 2(b) & 441 (1)
CAA 01

12.4 Expenditure on land, buildings and structures generally does not qualify.

12.5 Section 837B ICTA 88 "Meaning of oil & gas exploration and appraisal" formalises the previous agreement with HMRC in the 1967 memorandum that the costs of searching for, discovering and testing new oil deposits in the UK and UKCS can qualify as research and development expenditure provided that they are incurred before the presence of oil in commercial quantities has been established and the decision taken to proceed to field development.

Given the practical difficulty of identifying the timing of such a decision, the date of Annex B consent is generally taken as a convenient reference point. However, this represents only the date beyond which expenditure cannot qualify for research and development allowance (R&DA), and in practice there is likely to be expenditure incurred before then which will have been directed towards development stage planning. Qualifying expenditure will include survey costs and the drilling and testing of both exploration and appraisal wells.

12.6 Once it is established that two or more companies are operating in the same oil field in which the existence of oil in commercial quantities has been proved by any one of them, R&DA will no longer be available to any of them.

12.7 In the case of non-UK interests, HMRC will frequently challenge any claim to R&DA and will generally require evidence from the claimant that the licensed area in question is not an area where there is a "well developed understanding of the geology concerned" – i.e., that the expenditure can properly be said to relate to scientific research.

12.8 Once a company has commenced its trading in a particular field it may continue with research in another field and claim the allowances up to the date of discovery of oil in commercial quantities in that field. SRA is also available where exploration is abortive.

12.9 The allowances are only available if the research is directly undertaken by the taxpayer or on his behalf. The decision in Gaspet Limited (formerly Saga Petroleum (UK) Limited) v. Elliss [1987] STC 362 considers the meaning of undertaken "on his behalf" within the context of agreements between parties. The purchase of second hand research will generally not qualify for R&DA but may qualify for MEA.

12.10 A recapture of allowances will arise where a licence is disposed of and proceeds are received which are attributable to value deriving from exploration expenditure on which R&DAs were given (Paragraphs 15.8 and 15.29).

Section 442 CAA 01

R&D tax credit

12.11 An R&D tax credit is available to small and medium-sized enterprises, equivalent to 225 percent of qualifying revenue expenditure incurred.

Section 1044 CTA 09

12.12 A credit is available to large enterprises and is equivalent to 130 percent of qualifying revenue expenditure incurred.

Section 1074 CTA 09

12.13 In both cases, the credit is available only for costs that are revenue and not capital in nature and is specifically not available to exploration and appraisal expenditure.

Section 1138 CTA 09

12.14 A consultation process is currently ongoing on the detailed design of an "above the line" credit for research and development expenditure which would enable companies with no corporation tax liability to claim a cash credit in respect of qualifying research and development expenditure.

Section 395-410 CAA 2001

Mineral extraction allowance

12.15 Capital expenditure incurred on the following will generally qualify for mineral extraction allowance (MEA):

(a) mineral exploration and access;

(b) the acquisition of a mineral asset (including mineral deposits, land comprising such deposits, and interests in or rights over such deposits or land);

(c) the construction of works in connection with the working of a source of mineral deposits which are likely to be of little or no value to the person working that source when the source ceases to be worked or, in the case of a foreign concession, valueless when the concession comes to an end.

Where expenditure under (b) is expenditure on the acquisition of land, only so much of that expenditure as exceeds the undeveloped market value of the land is qualifying expenditure. No MEAs are available to a purchaser of an oil licence in respect of that part of the purchase price attributable to the vendor's expenditure on mineral exploration and access which had qualified for a 100 percent revenue deduction.

Section 399 CAA 2001

Certain expenditure does not qualify for MEA, including expenditure on:

(a) acquiring the site of any works;

(b) works constructed for processing the raw product of a source, except a process to prepare the raw product for use as such;

(c) constructing buildings or structures for occupation by workers or for their welfare;

(d) constructing offices, except where not more than 10 percent of the cost in an otherwise qualifying building is attributable to office space.

Expenditure under heads (b) and (c) may qualify for industrial buildings allowances until it is abolished gradually by 2011. (Paragraph 12.22).

Section 418(1) CAA 2001

12.16 Provided a trade of mineral extraction is being carried on, allowances are available when the expenditure is incurred.
Standard allowances are at the rates of:

(a) 10 percent per annum on the reducing balance for expenditure on the acquisition of a mineral asset (Paragraph 12.14 (b));

(b) 25 percent per annum on the reducing balance for other qualifying expenditure.

Strictly, allowances should be computed separately for each item of expenditure. In practice, it is acceptable to pool (on a source-by-source basis) items of expenditure qualifying for 25 percent allowances.
Expenditure incurred after 16 April 2002 for the purpose of a ring fence trade may attract a first year allowance provided the expenditure is not:

(a) on acquiring a mineral asset;

(b) incurred by a company on the acquisition of an asset representing expenditure incurred by a connected company.

12.17 Where expenditure qualifies for both MEA and R&DA, either allowance may be claimed.

12.18 A recapture of allowances (or a balancing allowance equal to unrelieved expenditure less disposal receipts) may arise where assets representing qualifying expenditure are sold or cease to be used in the mineral extraction trade, or capital sums are received which are attributable to qualifying expenditure.

12.19 The amount of expenditure qualifying for allowances where a mineral asset is purchased second-hand is restricted to the lower of the price paid and the vendor's qualifying expenditure. In particular, expenditure on acquiring Petroleum Act licences, or interests therein, is disregarded to the extent that it exceeds the original licensee's payments (being that part of such a payment which is reasonable to attribute to the interest itself), or relevant part thereof, to the secretary of state for the grant of the licence, and is not apportioned to mineral exploration and access.

12.20 Expenditure on purchasing a mineral asset second hand will attract allowances at 25 percent and 10 percent. For expenditure related to mineral exploration and access the buyer will receive allowances at 25 percent on the minimum of the buyer's expenditure and the previous trader's expenditure. The balance of the buyer's expenditure is treated as expenditure on the acquisition of a mineral asset and receives allowances at 10 percent.

12.21 Pre-trading expenditure on mineral exploration is treated as incurred on the first day of trading and, provided the source has not then been abandoned, allowances will become available from that time. Where the source has been abandoned prior to trading, full relief will be given for any residue of such expenditure (and also any residue of qualifying expenditure on plant and machinery which has been sold, destroyed, demolished or abandoned), but only for expenditure incurred within the six years prior to trading. It appears that pre-trading expenditure on mineral assets, such as licences, which are sold or surrendered before trading begins may not qualify for MEA.

Industrial buildings or structures

Section 84 FA 08 Section 108 FA 08

12.22 Industrial building allowance (IBA), as described below, ceased to be available for expenditure incurred from 1 April 2011. Allowances are no longer available for old expenditure for periods beginning from the same date. There were transitional rules during the period under which IBAs were phased out.

Section 310 CAA 2001

12.23 An annual writing down allowance of four percent of construction expenditure, usually beginning in the year in which the building or structure was first used, used to be available. Where the building is located in an Enterprise Zone an allowance of 25 percent was available (this was withdrawn from April 2011, although balancing charges may be possible after that date)

Section 85 FA 2008 Section 56 CAA 2001

12.24 After 1 April 2008, the writing down allowance (calculated as above) was reduced by the following percentages:

Financial year beginning 1 April 2008	25%
Financial year beginning 1 April 2009	50%
Financial year beginning 1 April 2010	75%
Financial year beginning 1 April 2011	100%

When accounting periods do not correspond to the financial year, an apportionment is required.

12.25 The building or structure must have been used in respect of a qualifying activity which includes a trade consisting of working a source of mineral deposits. Mineral deposits include any natural deposits capable of being lifted or extracted from the earth. Buildings or structures erected onshore and in use for refining and processing, receiving and treating terminals, together with roads and jetties should attract IBAs. Buildings or structures provided for the welfare of workers may also have qualified. Offices did not qualify, except where not more than 25 percent of the cost in an otherwise qualifying building is attributable to office space. Expenditure on the acquisition of, or of rights in or over, land did not qualify.

Machinery and plant

12.26 Expenditure on machinery and plant is likely to qualify for a standard annual writing down allowance of either 8 percent (10 percent prior to April 2012) if the asset is a long life asset (useful economic life of 25 years or more), or 18 percent from 1 April 2012 otherwise (20 percent prior to 1 April 2012). Allowances are given on a reducing balance basis. Restrictions apply to expenditure on certain cars and (for relevant leases entered into before 1 April 2006) overseas leasing assets. In addition, from 1 April 2008, expenditure on "integral features" is subject to a 8 percent annual writing down allowance (10 percent prior to 1 April 2012).

Section 33A CAA 2001

12.27 A first year allowance of 100 percent (including long life assets) is available to ring fence trades. To qualify, the expenditure on plant and machinery must be:

(a) qualifying expenditure on plant and machinery or mineral extraction activities;

(b) incurred by the company on or after 17 April 2002; and

(c) for use wholly for the purpose of the ring fence trade.

12.28 The first year allowance is withdrawn if, within five years of incurring the expenditure:

(a) the assets are used for another trade; or

(b) the assets are not used in the ring fence trade.

Section 45 G CAA 2001

12.29 Certain expenditure will not qualify for first year allowances. Examples of these are:

(a) expenditure on seagoing ships and railway assets incurred before 2001;

(b) plant and machinery purchased for leasing;

(c) decommissioning costs (100 percent relief is available as abandonment expenditure for assets used for the purpose of a ring fence trade);

(d) pre-trading expenditure on plant and machinery incurred before 17 April 2002, treated as incurred on the first day of trading.

Section 46 CAA 2001
Section 50 CAA 2001

There are transitional provisions for expenditure incurred under contracts spanning these dates.

Section 130 CAA 2001
Section 135 CAA 2001

12.30 Expenditure on new or second-hand ships qualifies for free depreciation, that is to say as much or as little for the first year allowance or writing down allowance as has become available may be claimed in any period at the taxpayer's option.

There are also special rules regarding the capital allowances treatment of proceeds arising on the disposal of a ship; from 21 April 1994, these rules include the facility to roll over any capital allowance balancing charge (subject to a "lower of" test) against the capital allowance base cost of ships acquired within three years of the disposal. The relief was extended in 1996 to allow rollover against a replacement by another company in a 75 percent group where the disposal occurs after 28 April 1996. The claim must be made within two years. Generally, rigs registered as ships, designed as ocean-going and travelling under their own power would qualify as ships, although this matter is not free from doubt. (Refer to the Special Commissioners' decision in Lavery v. McLeod [SpC 118, 2000] where the definition of a ship was discussed extensively in relation to a jack-up rig). Other drilling rigs will be treated as machinery and plant. Oil rigs and platforms, accommodation barges, light and weather ships, etc are not generally regarded as ships.

Section 166 CAA 2001

12.31 Where there is a transfer of a field interest (Paragraph 15.26) which includes plant and machinery on which the vendor has had allowances, the purchaser's plant or machinery allowances will generally be restricted to the lower of the price paid and the original cost to the vendor.

Section 167-171 CAA 2001

12.32 Rules for production sharing contracts were introduced in 2000. These apply where a contractor is entitled to an interest in a contract made with a government of a territory and the contract states that plant and machinery which the contractor provides (and is used for qualifying purposes) shall be transferred to that government. The contractor remains entitled to claim capital allowances until such time as the plant or machinery ceases to belong to the government or ceases to be used, or held for use, by any person under the contract. Similar provisions apply to participators who acquire interests in the contract. Where the participator buys into a contract interest and some of the expenditure is attributable to expenditure on plant and machinery of the contractor or another participator, there is a deemed disposal by the vendor of the relevant plant and machinery.

12.33 If the company fails to make a claim, the expenditure will be eligible to be claimed in later accounting periods. In contrast, for accounting periods ending prior to 1 December 1993 a company received capital allowances without making a separate claim, unless it elected to disclaim all or part of its first year or writing down allowances within two years of the end of the accounting period.

Section 3 CAA 2001

12.34 There is no specific definition of machinery or plant in the legislation, though examples are given of items which do not fall within the category. The term, however, covers a very wide range of assets from pipelines to office furniture. It includes production rigs, whether fixed or floating, and large parts of offshore and onshore facilities.

Section 21-24 CAA 2001

12.35 Capital allowances are now available on the costs of preparation for re-use of oil rigs, and also for the costs of removing and mothballing oil installations where their fate has not been decided. 100 percent capital allowances will be available where this takes place in connection with the closing down of an oilfield (both as part of a programme of abandonment and, from 12 March 2008, for mid-life commissioning). Otherwise, allowances are available on a 25 percent reducing balance basis assuming that the expenditure does not qualify for first year allowances.

Sch. 18 (82) FA98

A claim for capital allowances should be made in the corporation tax return. Claims must be made within two years from the end of the accounting period and may be revised by amending the tax return.

12.36 The taxpayer may elect for capital allowances to be calculated separately on machinery or plant acquired from 1 April 1986 which is likely to be disposed of within five years, so as to give full relief for depreciation over the period of ownership (short life asset treatment). Otherwise, the annual writing down allowance is normally computed as a single amount on the pool of unrelieved expenditure and not in respect of each specific item of plant and machinery.

Section 85 & 86 CAA 2001

12.37 An annual investment allowance was introduced from 1 April 2008 being £50,000 per annum per group of companies. The allowance was increased to £100,000 from 1 April 2010 yet the Emergency Budget 2010 announced the reduction of the investment allowance to £25,000 from 1 April 2012.

'New Brunswick' expenditure

Section 137
CTA 2009

12.38 On basic tax principles, it might be considered that intangible drilling costs represented expenditure of a capital nature on which capital allowances were available. However, in pursuance of a decision of the Special Commissioners in 1920, HMRC accepted that, once the first development well has won access to an oil deposit, the intangible drilling costs of subsequent production wells were deductible for tax purposes as revenue items, even though they may be capitalised in the accounts. In reference to the 1920 decision, such costs are often referred to as 'New Brunswick' expenditure. Expenditure incurred after 25 November 1996 on intangible costs of drilling production wells (subsequent to the first production well) is deductible as follows:

- 100 percent receive relief on expenditure incurred before 26 November 1997 under a contract entered into before 26 November 1996;
- After April 2002 'New Brunswick' costs should obtain a 100 percent first year allowance inside the ring fence.

Long life assets

Section 90
CA2001
Section 91
CAA 2001
Section 102
CAA 2001
Section 52
CAA 2001

12.39 A long life asset is machinery or plant which it is reasonable to expect will have a useful economic life of at least 25 years. The useful economic life is defined as the period from first use until the asset ceases to be used as a fixed asset of a business. Writing down allowances are given at 8 percent from 1 April 2012 on long life assets on a reducing balance basis. First year allowances of 100 percent are available on long life assets used in a ring fence trade where the expenditure was incurred on or after 12 March 2008. Between 16 April 2004 and 11 March 2008, the rate was 24 percent.

12.40 Expenditure on long life plant and machinery will usually be allocated to a long life asset pool. There is a lower limit on expenditure, being £100,000 per annum, except that the limit is divided by one plus the number of associated companies.

Section 146
CAA 2001

12.41 HMRC has said that it will generally accept accounting treatment in determining whether an asset is a long life asset. However, specific legislation provides that, in relation to expenditure incurred before 1 January 2011, ships of a seagoing kind, except oil/gas rigs, cannot be long life assets.

Grants or contributions

12.42 In general, any contribution made to capital expenditure by another person will reduce the expenditure for capital allowance purposes except in certain circumstances, including where the contribution relates to insurance or compensation money or, broadly, where the contributor cannot claim allowances/a deduction for the expenditure.

12.43 Where a contribution reduces the expenditure qualifying for capital allowances, the contributor may, in certain circumstances, be entitled to capital allowances itself.

Exploration Expenditure Supplement (EES)

12.44 The EES was introduced in 2003 to encourage UKCS exploration and appraisal but has been replaced by ring fence expenditure supplement from 1 January 2006 (see 12.51). The EES measures enhance the value of unused capital allowances for UKCS taxpayers who are unable to make immediate use of them. EES is available to companies chargeable to ring fence corporation tax (see paragraph 11.24).

ICTA Sch 19B Para 2

12.45 Broadly, both start-up E&A companies and existing E&A companies which are not paying corporation tax can benefit from this supplement.

ICTA Sch 19B Para 4

12.46 Companies undertaking exploration and appraisal in the UKCS, which are not yet trading or which do not have a tax liability sufficient to use the capital allowances available on that expenditure can claim EES on qualifying expenditure incurred on or after the 1 January 2004. Unused capital allowances benefit from EES, for a maximum of six accounting periods (which need not be consecutive).

ICTA Sch 19B Para 5

12.47 EES is an annual uplift of six percent, on a cumulative basis, of the balance of the unused capital allowances carried forward. However, the amount of expenditure qualifying for EES is reduced by any ring fenced profits arising in another group company.

ICTA Sch 19B Para 7

12.48 Where a company has allowances for different types of expenditure, it will be able to choose how to use them in order to gain maximum advantage from the EES. Generally, where any exploration and appraisal expenditure is incurred before the company is considered to be trading for tax purposes, capital allowances on that expenditure can be claimed when the company begins to trade. The six percent EES uplift accrues as the expenditure is incurred. Pre-trading expenditure is pooled, and cumulative EES can be claimed on the pooled expenditure in the first year of trading.

ICTA Sch 19B Para 9 and 10

Ring fence expenditure supplement (RFES)

Section 307
CTA 10

12.49 This provision applies to expenditure incurred from 1 January 2006. It replaces the exploration expenditure supplement (EES) which applied from 2003 until 2005 and is effectively an extension of that relief as RFES applies to any oil extraction related expenditure (EES was limited to E&A expenditure). RFES enhances the value of unused allowances or losses for oil companies which are unable to make immediate use of them with the intention of maintaining the time value of oil extraction expenditure.

Section 310
CTA 10

12.50 Companies carrying on a ring fence trade or engaged in pre-trade activities for such a trade may claim an annual supplement of 10 per cent on a cumulative basis (but not for more than six accounting periods, including any where EES claims were made) in respect of qualifying pre-commencement expenditure or losses incurred in the trade. The accounting periods for which RFES is claimed need not be consecutive.

12.51 The rate applicable for RFES claims in respect of periods from 1 January 2006 to 31 December 2011 was 6 per cent. If the accounting period is less than 12 months long, the RFES rate is reduced proportionately.

Section 315
CTA 10

12.52 There are separate rules for claiming RFES, depending on whether the company has commenced a ring fence trade or is engaged in pre-commencement activities. For qualifying companies that are pre-trading RFES is claimed as a pre-commencement supplement on expenditure. A qualifying company which incurs qualifying expenditure following the commencement of trade claims RFES as a post-commencement supplement.

Section 325
CTA 10

12.53 Put briefly, supplement is available for periods until ring fence profits, calculated on a group basis, exceed the sum of:
(a) brought forward unused EES expenditure;
(b) ring fence losses from 1 June 2006; and
(c) RFES.

The reference amount and hence the RFES claim is reduced where ring fence losses are utilised against ring fence profits. There are detailed rules associated with RFES but they are outside the scope of this book.

Chapter 13

Decommissioning costs: corporation tax

13.1 Decommissioning remains a significant industry issue. The PRT provisions are outlined in Paragraph 5.3 and Appendix I. This chapter outlines the CT aspects. It will be seen that, in many respects, these mirror the PRT position.

Clarity over the treatment of decommissioning expenditures is seen by the industry as being of particular importance as many of the larger fields commence abandonment programmes. In recent years, there have been a number of changes to the rules on decommissioning, with the most significant change being the restriction on the rate of relief available.

At the time of writing, the initial consultation period has recently closed with regard to the proposed introduction of a "Decommissioning Relief Deed". This proposal seeks to provide contractual certainty with regard to tax relief for decommissioning expenditure.

Decommissioning expenditure

13.2 Licence participators may make use of Decommissioning Cost Provision Deeds (DCPD) primarily in order to agree the various partners' shares of future decommissioning cost and related matters. HMRC have set out their view as to the tax treatment of monies paid into the trust, the income arising in the trust, and monies paid out by the trust in their tax manuals (OT 28600), Broadly, they consider that:

- no CT deduction is due to companies involved in the DCPD until decommissioning costs are met by sums held by the trust (ie payments into the trust are disallowed); and
- The monies in the trust will be subject to both income tax and inheritance tax as the trust is effectively an accumulation trust.

However, industry is not in full agreement with HMRC's views on this, and some other decommissioning issues, and discussions are therefore ongoing such that the tax implications of DCPD's are likely to evolve.

Section 164 CAA 2001

Section 164(5) CAA 2001

13.3 A special allowance is available, on election, to a person carrying on a ring fence trade, for expenditure incurred from 12 March 2008 on the decommissioning of offshore machinery and plant (which has been brought into use for the purposes of a ring fence trade and which is, or forms part of, an offshore installation or a submarine pipeline) broadly in connection with an approved abandonment programme, effectively allowing for mid-life decommissioning.

The amount of the special allowance is equal to the amount of general decommissioning expenditure incurred in the chargeable period. The relief is available for expenditure on decommissioning carried out in the chargeable period or the previous chargeable period. Relief is also available in a chargeable period for expenditure incurred in an earlier period, on decommissioning actually carried out in that chargeable period. These rules reflect the anti-avoidance measure introduced in FA 2009 to ensure that relief is not available in advance of carrying out the work.

Section 164(z) CAA 2001

The election, which is irrevocable, must be made within two years of the end of the chargeable period. To the extent that the allowance gives rise to a trading loss in the period, that trading loss may be carried back against profits arising in a period three years (as opposed to the usual 12 months) prior to the loss period (but see paragraph 13.12 below).

13.4 If an election is not made, the expenditure will be treated as being eligible for writing down allowances in the usual way (currently 100 percent first year allowance) but without the increase period allowed for carry back of losses.

Section 165 CAA 2001

13.5 This allowance replaces the offshore abandonment allowance which was only available, prior to 12 March 2008, in connection with the partial or total closure of a field. From 12 March 2008 until 21 April 2009, there was no requirement for the expenditure to be undertaken under an approved abandonment programme, nor was there any requirement for the work to have been done before the end of the accounting period, the relief was for the whole of the expenditure. From 21 April 2009, the expenditure must relate to an approved abandonment programme or, broadly, relate to a condition imposed by, or agreement with, the Secretary of State before the approval of such a programme.

13.6 For expenditure before 12 March 2008 relief was only available if incurred within three years of the cessation date.

Relief in respect of decommissioning expenditure

Section 330A CTA 10

13.7 Measures introduced in Finance Act 2012 restricted the rate of relief that ring fence companies can claim on decommissioning expenditure incurred. An adjustment is made such that the effective rate of relief on the decommissioning expenditure for SCT purposes is restricted to 20%.

13.8 The mechanism applies such that a fraction of any decommissioning expenditure relieved in a period is added back to increase the profits subject to SCT at the prevailing rate. This fraction is:

* (Rate of SCT in the period – 20%) / (Rate of SCT in the period)

Based on an SCT rate of 32%, this gives an add-back for SCT equivalent to 37.5% of the decommissioning expenditure relieved in the period.

13.9 This rule does not apply in respect of periods to which decommissioning expenditure is carried back and relieved and in which the rate of SCT was 20% or less.

13.10 There is also a mechanism to avoid a high effective tax rate where PRT repayments are received as a result of decommissioning and that income would ordinarily be subject to SCT at a rate of more than 20%. This seeks to ensure that the principles governing the restriction of decommissioning relief are applied consistently to PRT and non-PRT fields.

Post-cessation decommissioning expenditure

Section 165 CAA 2001

13.11 Where a person's ring fence trade ceases and he incurs expenditure during a post-cessation period (broadly up until the time the abandonment programmes is completed) which would qualify for the special allowance if he were still trading, the expenditure (net of any scrap proceeds) will be added to his plant and machinery qualifying expenditure for his final trading period. The expenditure incurred will qualify if the work was carried out at an earlier time, and not just in the post-cessation period. As with the main allowance, relief will not be available in advance of carrying out the work. A 100 percent allowance will therefore be available to him for that period and as the trade has ceased, may generate a termination loss which can be carried back for three years (see paragraph 13.6 above). This provision potentially addresses the difficulty that post-cessation expenditure of this type would otherwise not be relievable under the ordinary rules.

For expenditure before 12 March 2008 relief was only available if incurred within three years of the cessation date.

Losses of ring fence trade - extended carry back

Section 42 CTA 10

13.12 Where a loss of a ring fence trade arising on the cessation that trade (a terminal loss) or one from general decommissioning expenditure is not fully relieved by three-year carry back, it may be further carried back against ring fence trade profits of earlier periods, taking later periods before earlier periods. Such losses may not be carried back beyond 17 April 2002 (introduction of the supplementary charge).

Expenditure on and under abandonment guarantees

Section 292 CTA 10

13.13 To the extent that expenditure incurred on obtaining an abandonment guarantee is allowable for PRT purposes under section 3(1)(hh) OTA (Appendix I.13), it will also be an allowable deduction in computing ring fence income. Also, as for PRT (Appendix II.7), expenditure met out of a receipt under such a guarantee is not allowable as a deduction. Where the expenditure incurred on obtaining an abandonment guarantee is not allowable for PRT purposes under Section 3(1)(hh) OTA due to the field not being a taxable field, it may be a capital expense and may not be allowable as a deduction in computing ring fence income. This is generally recognised by HMRC as being anomalous and is to be addressed at some stage.

Relief for reimbursement expenditure

Section 295 CTA 10

13.14 Where a guarantor has made a payment under an abandonment guarantee, and the participator in question then reimburses any of that payment, the participator may obtain CT relief for the reimbursed amount. Definitions and restrictions are similar to those applying for PRT purposes (Appendix I.14).

Relief for expenditure incurred in meeting a defaulter's abandonment expenditure

Section 296 CTA 10

13.15 Expenditure under this head incurred after 18 March 1991 which is eligible for PRT purposes under paragraph 2A Schedule 5 OTA (Appendix I.19) is also allowable, by capital allowance or deduction against ring fence income as appropriate, for CT purposes.

Reimbursement by defaulter

Section 298 CTA 10

13.16 Again, this provision mirrors the PRT legislation as set out in section 108 FA 1991 (Appendix I.20). Where a defaulting participator reimburses a participator ('qualifying participator') who has incurred qualifying expenditure under section 64 FA 1991 (Paragraph 13.11), that reimbursement expenditure will be deductible against the defaulter's ring fence income. The receipt will be an income receipt of the qualifying participator's ring fence trade in the accounting period in which it was received. If received after the cessation of the qualifying participator's ring fence trade, it will be treated as a receipt of the last accounting period of that trade. The receipt is only ring fence income to the extent that it does not exceed the amount of the qualifying participator's qualifying expenditure under section 64 FA 1991.

Period of CT chargeability of PRT repayments

Section 300 CTA 10

13.17 A repayment of PRT generally results in an increase in the CT liability for the accounting period for which the PRT in question was originally deducted. However, where a repayment arises from the carry-back of a PRT field loss, it will be treated as ring fence trading income of the accounting period in which the PRT period of loss ends. If the ring fence trade has already ceased by that time, it will be brought in as a receipt of the final trading period. This provision is not specifically abandonment related, but it results in the CT income resulting from the PRT repaid arising in the period in which abandonment expenditure is incurred and thereby potentially sheltering the CT adjustment.

Consultation on Decommissioning Relief Deeds

13.18 In an effort to provide the industry greater certainty over the tax relief, particularly in situations where there are a number of different parties with potential responsibility to meet the decommissioning liabilities, HM Treasury launched a consultation in July 2012 on introducing Decommissioning Relief Deeds. The legislation, expected to be introduced as part of Finance Bill 2013, is expected to give the power for HMRC to enter into binding contracts with individual company counterparties to define the amount of relief it can claim in respect of expenditure incurred in meeting its own decommissioning liabilities and in the situation where it is required to meet other parties' decommissioning liabilities.

Chapter 14

Capital gains

14.1 The legislation concerning tax on capital gains contains an increasing number of provisions relevant to oil and gas companies with interests in the UK and UK Continental Shelf. These are summarised below. Questions arising from the disposal of licence interests are discussed in Chapter 15.

Ring fence capital gains are covered in Paragraphs 11.29-11.32.

Exploration or exploitation rights and assets

Section 276 & Section 199
TCGA 92

14.2 Several of the ring fence legislative provisions (for example s199 and s 276 TCGA 1992) refer to exploration or exploitation activities, rights and assets.

(a) Exploration or exploitation activities are activities carried on in connection with the exploration or exploitation of the seabed and subsoil (and their natural resources) of the UK or its Continental Shelf.

(b) Exploration or exploitation rights are rights to, or to an interest in or to the benefit of, assets to be produced by such activities; they include unquoted shares which derive the whole or the greater part of their value, directly or indirectly, from such rights.

(c) Exploration or exploitation assets are assets which are either:

(i) non-mobile assets, in use at some time in connection with exploration or exploitation activities in the UK or its Continental Shelf; or

(ii) mobile assets so used which are dedicated to an oil field in which the person making the disposal, or someone connected with him, is or has been a participator.[1]

Section 10(B)
TCGA 1992

14.3 A UK-resident company is subject to tax on capital gains arising on the disposal of any of its chargeable assets worldwide. A non-resident company trading in the UK through a permanent establishment is generally subject to tax on capital gains only in respect of relevant UK assets situated in the UK. A non-resident company which does not trade in the UK through a permanent

[1] The meaning of "mobile" and "dedicated to a field" is taken from OTA 1975. For disposals prior to 14 March 1989, exploration or exploitation assets were only classified as such if they had met the usage condition set out in Paragraph 14.2 (c)(i) or (ii) above within the period of two years ending with the date of disposal.

establishment would not therefore expect to be taxable on its disposal of UK assets. Similarly, a non-resident company trading in the UK through a permanent establishment would not normally expect to be taxed on its assets outside the UK – e.g., those on the UKCS.

14.4 However, these provisions are modified in respect of:

Section 276(7) TCGA 92

(a) exploration and exploitation rights relating to a designated area;

(b) exploration and exploitation assets situated in a designated area; and

(c) unquoted shares deriving their value or the greater part of their value directly or indirectly from exploration or exploitation assets or rights.

A non-resident company disposing of such assets or shares will be within the scope of UK tax in relation to any capital gain. This will apply, for example, to an overseas company disposing of its shares in a North Sea exploration company, subject to the application of the substantial shareholding exemption (Paragraph 14.15).

Unrealised gains in assets

14.5 Where an exploration or exploitation asset within Paragraph 14.2(c)(ii) above ceases to be a chargeable asset because it ceases to be dedicated as described, it is deemed to have been disposed of and immediately re-acquired at its market value.

Section 199 TCGA 92

14.6 Where a non-resident ceases to carry on a trade in the UK through a permanent establishment, he is to be deemed to have disposed of and re-acquired at market value any asset within Paragraph 14.2(c)(i) above.

Section 199(2) TCGA 92

14.7 Paragraph 14.6 is not to apply merely because a person has closed down his permanent establishment in the UK while continuing to carry on exploration or exploitation activities (since both trade and assets would then continue to be within the charge to UK tax – Paragraphs 14.4 and 17.3). However, if this happens and he subsequently ceases to use the asset in question for exploration or exploitation activities, he is treated as having then disposed of and re-acquired the asset at its market value.

Section 199(4) & (5) TCGA 92

Assets held at March 1982

Section 35 TCGA 92

14.8 Under general UK tax law, assets held by a person at 31 March 1982 and disposed of after 5 April 1988 are, for capital gains purposes, generally treated as having been re-acquired by him on 31 March 1982 at their then market value.

14.9 However, if this provision would, on the disposal, produce a capital gain where there would otherwise have been a loss, or produce a loss where there would otherwise have been a gain, the disposal is treated as giving rise to neither gain nor loss. Alternatively, where the provision would produce a larger gain or a larger loss than would otherwise have arisen, the provision is to be ignored and the gain or loss computed without reference to the March 1982 value.

Section 55(2) TCGA 92

14.10 For these purposes, the gain or loss in question is computed net of indexation based on whichever is the higher of the March 1982 value and original cost. However, for disposals on or after 30 November 1993, the rules regarding indexation allowance are changed: though the allowance may still eliminate or reduce a capital gain, it can no longer create or increase a loss. This does not effect the operation of the rule at Paragraph 14.9, though it may reduce or eliminate any loss which would otherwise have arisen.

14.11 In general, a person can make an election (subject to certain time limits) to disapply the rules at Paragraph 14.9 and to apply the rules at Paragraph 14.8 strictly: the election must cover all of a person's assets held at 31 March 1982, and it is irrevocable. In such a case, indexation allowance, too, will be computed on the March 1982 value.

Para. 7 Sch. 3 TCGA 92

14.12 Where such an election is made, it does not apply to plant and machinery or other assets used in connection with a trade of working mineral deposits on which capital allowances have or could have been claimed; nor does it apply to Petroleum Act licences. In such cases, therefore, the use of the 31 March 1982 value can never increase a gain or a loss, and any gain or loss is restricted to that computed on the base of original cost (or 6 April 1965 value, if appropriate).

Para. 7 Sch. 3 TCGA 92

14.13 The exclusion from the March 1982 rebasing election, described in Paragraph 14.12, extends also to unquoted shares deriving the whole or the greater part of their value from oil exploration or exploitation rights and/or assets.

14.14 The above provisions were designed to ensure that exceptionally large capital losses did not accrue to companies as a result of disposing of assets whose March 1982 value was, because of the high price of oil in that year, exceptionally high in relation to their cost. However, it would still have been possible that, even where rebasing had been excluded because it would lead to an increased loss, the smaller loss based on cost might include an 'artificially' high indexation figure based on the March 1982 value (Paragraph 14.10).

Substantial Shareholdings Exemption (SSE)

14.15 FA 2002 introduced rules that can, in certain circumstances result in the disposal of shares in which the vendor has a 'substantial shareholding' being exempt from UK taxation. This broadly brought the UK into line with a number of other European tax regimes, where participation exemption rules provide an exemption from gains for disposals of significant holdings of shares in companies held as active investments. The exemption rules may also apply to non resident vendors brought within the charge to UK corporation tax (see Paragraph 14.4 above).

Sch 7AC
TCGA 92

14.16 Broadly, under the UK SSE rules, where:

- a trading company or a member of a trading group,
- holds 10 percent or more of the issued ordinary share capital,
- of another trading company (or holding company of a trading sub group),
- for a continuous period of at least 12 months ending not more than one year before disposal,

Paras 7, 8, 18 & 19
Sch 7AC
TCGA 92

The gain on the sale of all or part of that holding is exempt from UK corporation tax.

14.17 No claim is required to be made, as the exemption applies automatically if all of the necessary conditions are satisfied.

14.18 A trading company is one carrying on 'trading activities'. 'Trading activities' include activities carried on by a company:

- in the course of, or for the purpose of, a trade actually being carried on by the company, or
- in preparing to carry on or with a view to the acquiring or starting of a future trade (and this may include oil exploration companies even in the exploration phase), or

- with a view to the company acquiring a 'significant interest' in another company which is a trading company or the holding company of a trading group or sub group and as a result of the acquisition both companies will become members of the same group or the acquired company will become a qualifying shareholding in a joint venture company, but will not be a member of the same group.

14.19 A 'trade' is defined as anything which is a trade, profession or vocation (as understood for tax purposes) and is conducted on a commercial basis with a view to the realisation of profits. Non trading activities must not represent a 'substantial' part of the company's total activities. Although the word 'substantial' is not defined in the rules, HMRC guidance provides that activities amounting to more than 20 percent should be substantial.
In determining whether a company's or a group's non-trading activities are substantial, HMRC will consider:

(a) income from non-trading activities,

(b) the non-trading asset base of a company, (e.g., surplus cash, assets no longer used in the trade, goodwill), and

(c) expenses incurred, or time spent, by officer and employees of the company in undertaking its non trading activities.

Further detailed consideration of these provisions is beyond the scope of this book.

Intra-group transfers

Section 171 TCGA 92

14.20 UK tax law allows for capital gains tax free transfers of assets between UK resident companies within a 75 percent group headed by a common parent regardless of whether that company is resident in the UK or not. Under such circumstances, the transferee inherits the transferor's base cost for capital gains purposes so, in effect, any tax is deferred until a later sale of the asset outside of the group. Where a transferee company is sold and leaves the tax group whilst owning the transferred asset (without the transferor company leaving at the same time), that transferee company will be subject to a degrouping charge at that time. The charge is calculated as if the transferee had sold (and reacquired) the asset in question at the time of the original intra-group transfer, based on the market value at the time.

Section 179 TCGA 1992

14.21 Provided certain conditions are met, the gain (loss) arising on the deemed disposal is added to (subtracted from) the consideration received by the company disposing of the shares in the transferee company, when it leaves the group. These provisions allow, in certain circumstances, groups to transfer trade and assets to a new company on a tax-free basis and dispose of the shares in this company without triggering a capital gain.

14.22 These intra-group transfer provisions are extended in relation to the intra-group disposal of exploration or exploitation rights or assets (see Paragraph 14.2). In such cases, the requirement that the transferee and transferor must be UK resident is disregarded where the transfer is either:

Section 276(8) TCGA 92

(a) between companies resident in the same territory outside the UK; or

(b) from a company resident outside the UK to one resident within it.

Wasting asset rules

14.23 A licence is in almost all cases a wasting asset which has a life of less than 50 years. As a licence is an interest in land, the cost of the licence will be reduced (i.e., wasted), by reference to its original life following the rules in Schedule 8 of TCGA. However, if the wasting asset qualifies for capital allowances (whether capital allowances were claimed or not) the wasting asset rules do not apply.

Section 44 TCGA 92

14.24 As the original licence payment will generally qualify for capital allowances, this expenditure will not be wasted for capital gains purposes. However, an acquiring company may have incurred expenditure that does not qualify. If this is the case, that company's expenditure may be subject to the wasting rules. In addition, a rebased licence may be subject to the wasting rules.

Holdover relief and reinvestment relief

14.25 Rollover relief (a deferral of a gain) or the new reinvestment relief (a complete exemption) may be available on the disposal of licence interests and these reliefs are discussed in more detail in Chapter 15.

Part 4 - Transfers and Special Transactions

Chapter 15

Transfers of licence interests

15.1 This chapter deals with UK and UKCS licences, though some specific issues concerning overseas licences are considered at 15.41.

The Secretary of State (currently for the Department of Energy and Climate Change (DECC)) is given the right to grant licences for oil and gas exploration and appraisal in the UK and the UKCS. The Secretary of State awards licences through competitive licensing rounds. The aim of the licensing round process is to award licences to bidders who optimise exploration of the licence area. Licences can be held by one or more companies. The companies share joint and several liability for operations conducted under the licence. Companies party to a licence may sell/align their interest in the licence. Assignments of licence interest must be approved by the Secretary of State. The adjustment by two or more companies of their percentage shareholding in a licence is not treated as an assignment and does not need Secretary of State approval.

The following should be taken as a very general indication of the likely tax treatment of changes in licence interests. In some cases, it would be advisable for taxpayers to agree tax consequences in advance with HMRC.

The two stages

15.2 The exploration and appraisal stage on a licensed area covers the whole period from the date exploration of the area begins to the time that the decision is taken to proceed to the second stage of field development and production. The distinction between these two stages is an important one for both CT and PRT purposes, and several statutory provisions turn on one or another of the various events which occur at or about the time of the development decision, as follows.

15.3 The approval of DECC to the field development programme will generally signal:

- the point beyond which expenditure on the area can no longer qualify for R&DA (Paragraph 12.5);
- for a licensee who has not yet commenced trading, the start of a petroliferous trade (Paragraph 11.3);
- the cut-off point for the possible application of the section 194 TCGA 1992 provisions on licence swaps and simple work obligation farm-outs (Paragraphs 15.14-15.17).

15.4 Once an oil field has been finally determined (ie a boundary drawn around the field) by DECC, then, irrespective of any development consent:

- the PRT provisions of Schedule 17 FA 1980 will apply (Paragraph 15.18) if the field is a taxable field;
- any capital gain arising on the disposal of the licence interest and field assets will generally be within the ring fence (Paragraph 11.29).

Pre-development stage transfers

Simple licence sale

15.5 For the vendor who is already trading, most of the expenditure on the area at this stage, whether onshore or offshore, will qualify for R&DA (Paragraph 12.5). If it is not yet trading, allowances in respect of past expenditure will become available on the date trading commences.

Until trading starts, there can of course be no trade losses available for surrender to other group companies. It may thus happen that a pre-trading company has accumulated many millions of pounds of potential R&DA without yet being able to derive any tax benefit.

15.6 Title to such potential R&DA relief would clearly have considerable value if it could be passed intact to a purchaser of the licence who, already trading, could utilise them at once.

15.7 However, R&DA is available only to the person by whom or on whose behalf the scientific research is undertaken (Paragraph 12.9). Thus, a trading purchaser of the licence interest would not, by reimbursing the vendor's expenditure, itself become entitled to R&DA. The non-trading vendor will, up

to a maximum of the amount reimbursed, suffer a restriction on its entitlement to future R&DA claims. If it is trading, and has already claimed the R&DA, it will suffer a clawback in the same amount. In the purchaser's hands, such a reimbursement may qualify for MEA subject to the restrictions outlined in 12.19. Any additional amount paid by the purchaser, beyond a simple reimbursement, will attract no relief.

To the extent that it reimburses the vendor's payment to the UK government for the acquisition of the licence, it will qualify for MEA at 10 percent (Paragraph 12.16). For a non-trading purchaser, MEA would become available from the time his own trade commenced.

15.8 In computing CT on any capital gain, the vendor will generally be able to deduct the cost of such expenditure on the licence as would have qualified for R&DA if it had already commenced trading. In the same way, a trading vendor who had already claimed R&DA would take an equivalent deduction for capital gains purposes but would suffer a clawback of the allowances already received.

15.9 Gains on the disposal of a UK licence interest fall within the CT ring fence provided that an oil field, under that licence, has already been determined by DECC (Paragraph 11.29).

15.10 From 1 July 1999, where the proceeds on the disposal of a UK licence interest are reinvested in a 'qualifying asset' any gain/holdover derived on disposal may be deferred under the rollover provisions.
Qualifying assets fall within six classes, including:

(a) building or part of building and any permanent or semi-permanent structure of any kind;
(b) any land occupied (as well as used) only for the purpose of the trade;
(c) fixed plant and machinery;
(d) ships, aircraft and hovercraft;
(e) goodwill.

The qualifying asset must be used in the ring fence trade of the company or another group company (see Paragraph 15.31 for details of the reinvestment relief).

Sale of shares

15.11 A clear alternative to the transfer of the licence interests would be the transfer of the shares in the licensee company itself. The company's title to R&DA would thus remain intact, and the purchaser could (assuming it was in a position to do so) trigger the commencement of the acquired company's trade, with immediate unlocking of the R&DA reliefs by, for example, transferring into it an interest in a licence which had already obtained development consent. Any trading loss thus created would be available for group relief surrender subject to the normal rules.

15.12 For PRT purposes, however, a transfer of shares would be rather more complex. The company would not be able to pass on to any new associates, under Section 5A(l)(a) OTA, the benefit of any past E&A costs for offset against their field income.

15.13 Against the possible E&A advantages of a share transfer must be set the potential CT cost in respect of any capital gain arising. Depending on how the financing of the company's exploration activities has been structured, a considerable chargeable gain could result from the transfer (subject to the availability of the substantial shareholding exemption – Paragraph 14.15). This consideration will apply no matter what stage activities on the company's licensed areas have reached.

Licence swaps and work obligation farm-outs

15.14 Paragraphs 15.6 to 15.13 above assume the case of a vendor wishing to dispose of its exploration stage licence interests for cash, and particularly where a company not yet trading intends to withdraw altogether from UK exploration. However, there are many circumstances in which exploration and appraisal stage licence interests may be transferred by a company wishing to rearrange its licence portfolio or to share the burden of its exploration costs. Important in this context are licence swaps and work obligation farm-outs.

15.15 Where one or more pre-development stage licence interests are exchanged in a bargain at arm's length for one or more similar interests with no other consideration passing, the disposal is treated for the purposes of both capital gains and capital allowances (including R&DA and MEA), as taking place for a nil consideration. Broadly, therefore, there will be no tax on chargeable

Section 194 TCGA 92 & Section 553 CAA 01

gains, and each of the parties will retain its title to R&DA in respect of expenditure already incurred; there will be no deemed reimbursement of past costs to qualify for MEA. For PRT purposes, similarly, each party should retain title to any E&A relief on past expenditure.

15.16 Similar rules apply in the case of a work obligation farm-out where, in a bargain made at arm's length, a licensee transfers a part of his interest in exchange for the purchaser agreeing to bear the whole of their joint costs of a specified drilling programme. Again, the consideration will be treated to that extent as nil, for both capital gains and capital allowances purposes. Such other consideration, representing a partial reimbursement of the farmer-out's past costs, will broadly be treated for R&DA purposes in accordance with the principles discussed above (Paragraph 15.8).

Historically, the costs subsequently incurred by the farmer-in under the terms of the agreement have been allowable to him in full, for R&DA relief subject to the normal rules, despite the fact that they are partly incurred in respect of the area still retained by the farmer-out. However, at the time of writing industry is in discussion with HMRC on this point over the letter's potential change of view in this regard.

Section 195(7) TCGA 92

15.17 Where, on a part disposal of a licence within Paragraphs 15.15-15.16 above, cash or other additional consideration also passes, the normal capital gains part disposal rules are amended. The effect of the amendment is generally understood to be that the allowable costs plus indexation for the licence as a whole are deductible in full, for capital gains purposes, up to the amount of the proceeds, so that no taxable gain will arise until proceeds exceed such costs plus indexation.

Development stage or later transfers

Simple licence sale - PRT

Section 195(7) TCGA 92 Sch. 17 FA 80

15.18 Once a taxable field has been determined (Paragraph 15.4), any transfer of a field interest falls within the provisions of Schedule 17 FA 1980, unless the transfer results from a field redetermination made under a unitisation agreement or from an illustrative agreement. Schedule 17 will not apply if both the old participator ('OP') and the new participator ('NP') (i.e., the vendor and the purchaser) elect within two months of the transfer that it shall not do so – provided that HMRC is satisfied that no material loss of tax will result from the election.

15.19 Subject to the above, Schedule 17 will apply for both straight cash disposals and any other transfers of the whole or part of an interest in an onshore or offshore field by a participator, whether or not the parties are connected with each other. A full analysis of the provisions is beyond the scope of this book, but the broad effect is that the NP will stand in the shoes of the OP for PRT purposes. Thus, any field expenditure incurred by the OP but not yet claimed by it will now be claimable by the NP. Any field expenditure claimed by the OP but not yet allowed to it, or any such expenditure allowed to it but not yet given effect in an assessment will pass to the benefit of the NP. The same applies to expenditure claimed or to be claimed by the field operator and allocated to the OP. Any brought forward field losses of the OP will also pass to the NP (but see footnote 1 on page 101). If the OP transfers only a part of its field interest, these rules will apply to the corresponding proportion of the expenditure and losses, except that none of the benefit of the OP's Schedule 6 expenditure (Paragraph 5.2) can pass to the NP unless the whole of the OP's field interest is transferred to it.

15.20 It follows that the amount received by the OP on the disposal of the field assets is not brought into charge to PRT as a disposal receipt; nor, conversely, does the NP have any relief for the amount it spends on acquiring the assets.

15.21 Certain anomalies in the Schedule 17 provisions should be noted. First, it may happen that the OP remains chargeable to PRT on its incomings for the period of transfer, whereas the NP taking the active interest will take over all benefits of expenditure claims for that period. The effect of this can generally be mitigated, but it is preferable to avoid the difficulty by having the transfer coincide with the beginning of a chargeable period. Secondly, if the transfer takes place in one of the first three chargeable periods of the field, no oil allowance is available to the old participator; however, since no PRT will generally be payable for these periods, no oil allowance will in any case be due so that the provision is likely to be of little effect. Finally, even where the transfer takes place at the beginning of a chargeable period, the OP may still have to submit a return for that period in respect of his licence debit or credit, if any (Paragraph 4.53).

Para. 17 Sch. 17 FA 80

15.22 If the OP itself has unrelieved E&A expenditure, the NP may inherit the title to this on two conditions:

Para. 16A Sch. 17 FA 80

(a) neither the OP nor any company associated with it must retain an interest in any UK licence;

(b) where the OP has made a succession of transfers of field interests, the NP in question must be a party to the last of these.

The OP's title to E&A expenditure will then pass to the NP, but only for set-off against the interest transferred to the NP and not, for example, against other of the NP's existing field interests.[1]

15.23 This loss restriction provision applies to a loss attributable not only to E&A relief but also to other non-field expenditure:

- abortive exploration expenditure (Appendix III.13);
- research expenditure (Paragraph 6.3);
- cross-field allowance (Paragraph 6.7); and
- unrelievable field losses derived from an abandoned field (Paragraph 6.11).

Simple licence sale - CT

Section 562 CAA 2001

15.24 In the case of a straight cash sale of a development stage or producing interest, a 'just and reasonable apportionment' of the consideration must be made between the assets transferred, any allocation given within the sale agreement itself not being necessarily conclusive of the matter.

15.25 Broadly, and depending on the stage which field development has reached, there are four basic elements which may be distinguished in the consideration, as follows:

- payment for the tangible field assets;
- payment which reimburses the amount originally paid by the OP to the Secretary of State for the award of the licence;
- reasonably attributed to the vendor's past exploration costs; and
- any further payment or premium in addition to the above.

These elements are dealt with, in order, below.

Section 62 CAA 2001
Section 166 CAA 2001

15.26 For the purposes of computing any balancing charge on plant or machinery included in the transfer (e.g., the platform and pipeline), the vendor will, under the ordinary rules, bring into its capital allowances computations

[1] The conditions for the transfer of E&A reliefs, as set out in the preceding paragraph, are very stringent. Until the Finance Act 1995, however, it was possible to circumvent them: before the transfer of the field interest, the OP would claim E&A expenditure against the field, and would thereby create a field loss which could be transferred to the NP in the normal way. For transfers after 28 November 1994, this is no longer possible: a field loss cannot be transferred to the NP to the extent that it is attributable to E&A relief claimed by the OP, unless the claim itself was made by the OP on or before 28 November 1994.

the disposal proceeds of the assets up to a maximum of their original cost to the vendor, with any excess being chargeable as a capital gain. However, the purchaser's capital allowances will be based not on the full amount paid by it for the plant and machinery, but on the amount brought into the vendor's capital allowances computations – i.e., giving a maximum basis equal to the amount originally paid by the vendor. This restriction only applies in the same circumstances as would Schedule 17, where the transfer is of an interest in a determined field.

15.27 At any stage in field life, any part of the consideration which simply reimburses the OP's payment to the Secretary of State for the original grant of the licence will qualify for MEA at 10 percent in the NP's hands, with the OP suffering (to the extent that it has already taken MEA on the expenditure) an equivalent clawback. This amount, though frequently insignificant, is occasionally material.

15.28 If the transfer takes place early in the field development phase, it may be that part of the purchase price can appropriately be allocated to value in the licence which is attributable to the OP's exploration and appraisal expenditure on the area. Even in a producing field, the same may be true – for example, if expenditure has produced the geological and geophysical data on which a second phase of field development is to be based. Such expenditure will probably have qualified for R&DA in the past, and that part of the consideration allocated to it will, up to a maximum of the R&DA already given, be clawed back in the form of a trading receipt of the OP. Similarly the NP's payment will, up to a maximum of the amount of the OP's expenditure to which the increase in value is attributable, qualify for MEA at 100 percent.

15.29 However, where the transfer is of a mature producing field interest, it will probably be argued that, commercially, no part of the consideration is properly attributable to the added value produced by the OP's exploration costs. Rather, any balance of the consideration over Paragraphs 15.26-15.27 above, may be seen as simply a payment for oil in the ground.

The consequence will be that the NP will secure no CT deduction for this element of the consideration (though the payment would, of course, contribute towards the capital gains basis in the asset). Similarly, the OP will not be disposing of any R&DA asset, and will thus suffer no recapture of R&DA but would potentially be chargeable to tax on capital gains in respect of this sum.

Holdover relief and reinvestment relief

15.30 A gain on the disposal of a UK licence interest, as noted in paragraph 15.10, may be deferred by reinvesting the proceeds (within a specified period) in a qualifying (ring fence) asset. The period of deferral will depend upon the class of asset being acquired but typically it will be a "depreciating asset" such that the period of deferral will end on the earlier of:

- the date the asset is disposed of by the company (or a qualifying group member) outside the (ring fence) group
- the date the asset ceases to be used in the ring fence trade by the company (or a group member)
- the expiration of a period of 10 years after the replacement asset is required In this way, the gain is said to be held over. In the unlikely event that the proceeds are reinvested into a non-depreciating qualifying asset, any gain is rolled over into the new asset and there is no 10-year limit.

Sch. 40
FA 09

15.31 Finance Act 2009 introduced a new "reinvestment relief" which provides for a complete exemption on any gain otherwise arising on the disposal (on or after 22 April 2009) of an interest in a UK licence. It should be noted that if the relief applies, the gain is fully exempt and there is no limitation on the qualifying expenditure associated with the reinvestment.

Where a company disposes of a ring fence asset, any resulting gain is exempt where the proceeds are reinvested by that company in qualifying assets ("oil assets") within the specified period.

Oil assets include interests in determined oil licences, pre-developed licences (but not undetermined licences with development consent), ring fence plant and machinery and certain other assets.

Section 198I
TCGA 92

Clarification to the legislation in FA 2011 confirmed that exploration, appraisal and development expenditure incurred in the course of a ring fence trade is to be treated as the acquisition of assets for the purposes of reinvestment relief.

Section 198H
TCGA 92

For disposals made on or after 22 April 2009, the acquisition of the assets can be made by fellow group company to the one making the disposal, provided that at the time of the acquisition the two companies are members of the same group.

Licence swaps

15.32 For UK licence swaps involving at least one developed area from 22 April 2009 there is a new relief. The exchange (called a "licence consideration swap") is to be regarded as a no gain/no loss transaction for both parties. If more than one licence is acquired, the deemed consideration is to be apportioned proportionately to market value (as determined under the swap arrangements).

15.33 Should one party receive non-licence consideration (perhaps equality money) (a "mixed-consideration swap") the disposal is still treated as "no gain/no loss" but the party receiving the non-licence consideration has its value deducted from his base cost on the acquisition. If the non-licence consideration exceeds this, he is treated as realising a capital gain. The company providing the non-licence consideration has it added to his base cost on acquisition.

Section 195A
TCGA 92

15.34 It remains to be seen whether the relief will be useful as it cannot apply if both parties give non-licence consideration. This could well happen if production assets are also exchanged. However, the Emergency Budget 2010 included an announcement that legislation would be introduced from Budget Day 2011 to include certain payments between the swap parties, typically interim period adjustments to consideration, within the exemption. It is therefore expected that such payments will be removed from the scope of taxation on capital gains.

Section 195C
Section 195D
Section 195E
TCGA 92

Sale of shares

15.35 There would be no internal PRT consequences to a company from a change in the ownership of its shares. There may be restrictions on the availability and use of certain losses. The vendor company, however, may be chargeable to tax on any gain arising on the share disposal, whether or not it is otherwise within the scope of UK tax (subject to the SSE rules, see Paragraph 14.15). If taxable, such a gain is not within the ring fence and rollover and holdover relief are not available; nor is an election for March 1982 rebasing of the cost of the shares (Paragraph 14.13).

Sch. 7AC
TCGA 1992

15.36 Commonly, if assets are standing at a gain, a field will first be hived down, in exchange for shares, to a new company ('Newco'), with the shares in Newco then being sold to the purchaser. In such a case, neither gain nor loss should arise to the OP on the transfer to Newco, with Schedule 17 FA 1980 (Paragraph 15.18) applying to a taxable field transfer for PRT purposes; no

Section 939
CTA 10
Section 171
TCGA 92

capital allowances adjustments should be necessary, with Newco taking over the OP's title to allowances as if there had been no transfer.

Gains on the subsequent sale of the Newco shares may be covered by the substantial shareholding exemption (SSE) where:

- at least 10 percent of the shares in Newco are owned; and
- the shares have been held for 12 months of the last two years.

Section 179
TCGA 1992

SSE will not be available to OP if Newco is sold within one year of being created. On leaving the group, a capital gain on the asset transferred will crystallise and will be chargeable, either in Newco (as a degrouping charge) or when certain conditions are satisfied, by adding the gain to (or subtracting the loss from) the consideration received by the company in its computation of the chargeable gains arising on the disposal of the shares in Newco. The degrouping charge in Newco can be allocated to OP if OP and Newco jointly elect to treat the gain as accruing to OP.

Both stages: capital gains on more complex farm-outs

15.37 Paragraphs 15.16-15.17 above deal with the capital gains position where there is a simple arm's length work obligation farm-out at the exploration or appraisal stage, and Paragraphs 15.9 and 15.24-15.29 refer to the straightforward cash sale of a licence or field interest. But there remain types of farm-out not within these categories: for example, an exploration stage farm-out not at arm's length; or a farm-out at the development stage, where the transferee may agree to bear the whole or part of the transferor's field development costs. In such situations, the capital gains position may be highly complex, and the following paragraphs set out to provide no more than a general guide to the position.

15.38 The essential point in such transactions is that HMRC considers that there is a disposal or part disposal of a licence interest where a farm out takes place. They will therefore seek to quantify the disposal proceeds (and hence the gains) by reference to the estimated value of the farm-out package to the farmer out.

15.39 In the simple work obligation farm-out not falling within Paragraph 15.16 above (ie in a developed licence situation), where A disposes of a proportion of his licence interest to B in exchange for the latter undertaking specific works,

HMRC contends that, for capital gains purposes, A is in receipt of disposal proceeds which are to be measured by the enhancement of the value in his retained interest which is attributable to the work to be undertaken for him by B.

15.40 A more complex farm-out might involve A, who owns the whole of the licence, arranging with B that the latter will pay for a development programme for the whole licence in return for a percentage of it. In addition, B will not only receive an interest charge for his expenditure but will also recoup himself from the oil derived by A from the percentage which A retains. In very broad terms, it could be said that B's expenditure in respect of A's retained interest was a loan on a non-recourse basis, with repayment being made out of oil. In these circumstances, HMRC might argue that the disposal proceeds for the percentage disposed of are the net present value of the difference of the cost of financing provided by B and the cost of obtaining similar financing facilities from an independent third party. This could involve an interest differential and possibly also a notional guarantee fee to reflect the fact that the loan is effectively non-recourse.

15.41 The rules at Paragraphs 15.14-15.17 above (tax-free treatment of licence swaps and work obligation farm outs) are extended to non-UK licences disposed of on or after 13 September 1995.

Chapter 16

Special transactions

Illustrative agreements

16.1 It has been a concern for the government to ensure that all oil and gas produced under UK licences is subject to UK CT. Until the passing of the Petroleum and Submarine Pipelines Act 1975, all corporate licensees of production licences were required to be resident in the UK for tax purposes, and also to be incorporated in the UK. Since companies resident in the UK are subject to tax on their worldwide profits, this ensured that any licence income would be subject to UK tax. Following the enactment of the Petroleum and Submarine Pipelines Act 1975, the 'residence and incorporation' requirement was removed from fifth and subsequent round licences. In practice, DECC has only been prepared to grant licences, or to permit the assignment of licences to overseas incorporated or resident companies, where they are satisfied that the licensee would be subject to UK tax. There is still a stipulation in licences that if a company fails to direct and control any commercial activities in connection with these operations from a fixed place within the UK it may have its licences revoked.

16.2 The requirement of UK residence was found inconvenient by overseas-based groups having UK licence-holding subsidiaries, since they were frequently prevented from obtaining tax relief for their expenditure in their home territory. Following negotiations in the mid-1960s with what is now HMRC and what is now DECC, it was agreed that the licensee could enter into an agreement based on an illustrative agreement under which the effective right to operate could be transferred to an overseas incorporated company or person, generally known as the 'X company'.

There was a requirement that the X company should either be a UK resident or carry out the activities under the illustrative agreement through a UK permanent establishment or branch. The purpose of this latter requirement was to ensure that the profits arising from the operations remained within the charge to UK tax. This was effective because an overseas resident company carrying on business in the UK through a permanent establishment would be subject to UK taxation. Thus overseas companies were able to obtain tax

relief for expenditure they had borne without risk to the UK tax take, being effectively treated, for both PRT and CT purposes, as if they were themselves the licensees.

Unitisation adjustments

16.3 There are no PRT provisions which relate specifically to unitisation other than those concerning transmedian fields (Paragraph 16.10) and, in particular, the provisions of Schedule 17 FA 1980 (Paragraph 15.18) do not apply to adjustments of field interests under a unitisation agreement.

16.4 The precise PRT treatment will depend on the terms of the relevant Joint Operating Agreement. Typically, disproportionate past liftings will be 'corrected' by revised lifting entitlements during a make-up period, and these revised liftings will simply form the basis for the computations of each licensee's PRT incomings. In addition, cash sums are likely to pass in order to adjust for disproportionate past shares of capex and opex. These will normally be dealt with by the operator putting in a single Schedule 5 claim (Paragraph 5.2) in respect of the unitisation: the total amount of the claim will be nil, but it will show the positive and negative amounts (of both expenditure and uplift) which are to be allocated to each participator in order to bring his share of past expenditure into line with his revised equity interest. Once agreed by HMRC, these amounts will be brought into the individual participator's next PRT assessment in the normal way (Paragraph 10.18): there will be no going back to reopen past claims or assessments.

16.5 Since the requirement to have reallocations of interest is inherent in the holding of unitised licences, HMRC takes the view that such adjustments do not involve disposals or acquisitions for capital gains purposes of the licences themselves.

16.6 However, CT problems can arise in relation to adjustments concerning capital expenditure under those licences. Where a premium over original cost is involved, capital gains may arise for the person receiving a unitisation adjustment. So far as capital allowances are concerned, a receipt under a unitisation adjustment would generally be regarded as a disposal giving rise to normal recapture. If there is a recapture in respect of revenue items, the excess over the original cost may be treated as income rather than capital gain. There may be problems for the payer of the unitisation adjustment, since items upon which the recipient will originally have received SRA or R&D will only

qualify for MEA (limited to the vendor's cost) in the hands of the payer. Plant and machinery allowances will also be restricted to the vendor's cost. To the extent that the adjustment is interest it will be taxed as income outside the ring fence to the recipient and tax relief will be available inside the ring fence, to the payer.

Gas banking

Section 108
FA 80

16.7 The tax legislation provides for the modification of the operation of HMRC in the case where i) a gas banking scheme is in place between participators in two or more fields, and ii) the participators elect for the prescribed modifications to apply.

16.8 The purpose of gas banking arrangements is to marry gas supply to production. Under the arrangement one field can act as banker for gas produced by another field. The producer field transfers gas to the banker field, in consideration for the reciprocal transfer of gas from the banker field at a later date. The banker field then regulates its own production to ensure that demand is just met. If production from a banker field exceeds its contractual disposals it is banked (short falls at other times can be made up by a withdrawal from the bank).

16.9 Under the basic PRT rules, the gas delivered from the other (taxable) field will be taxed on its participators when first produced, even if, as will be normal, the producers receive no payment. Where gas banking takes place, the Board of HMRC may make regulations adapting the normal PRT and CT rules to specific cases where all the persons concerned so elect. Certain regulations were enacted in the Oil Taxation (Gas Banking Schemes) Regulations 1982 (Statutory Instrument 1982 No 92). The provisions are not considered further here, but it should be noted that they will not cover all types of gas banking which could occur.

Transmedian line fields

Section 107
FA 80
Section 7(3)
OTA 83

16.10 Where unitisation agreements are made between UK and other governments for a taxable field falling between both jurisdictions, the PRT legislation is to have effect so that the participators in the UK part of the field will be taxed only on the oil apportioned to them under the agreement, with suitable revisions for redeterminations of the unitisations. Payments received by participators on a redetermination in respect of expenditure on a qualifying asset are treated as PRT disposal receipts.

16.11 On general principles, the UK licensees of such fields would be chargeable to CT on their profits. It is possible, however, that licensees of the other territory concerned will undertake activities in the UK or, as a matter of law, be construed to derive oil from the UK sources, such that there is an exposure to UK tax. Article 24 of the current UK/Norway double tax treaty therefore provides that each country may tax only production profits which arise to a licensee of that country over the life of a particular field, and only gains on disposal of assets owned by a licensee of that country. The provision only applies to fields where there is an agreement between the two countries which expressly provides for its application. There are such agreements in respect of the Statfjord, Murchison and Frigg fields and certain fields that straddle the Transmedian line.

Change of use activities

16.12 Mention has been made in Chapters 11, 12, 13 (and Appendix I) as to the general tax consequences of abandonment/decommissioning. However, in recent years it has become clear that North Sea assets will not necessarily cease being used upon decommissioning (of the oil production operations). For example, they may be used in gas storage, carbon capture and storage (CCS) or other power generating operations which would not constitute ring fence activities. Accordingly, certain changes have been made to both PRT and CT legislation (see paragraphs 16.13 and 16.14) to try and cater for such change of use activity where North Sea assets and infrastructure are reused for North Sea purposes other than oil and gas production. After these changes were introduced dialogue has continued between industry and HMRC to seek further amendments and clarifications in areas such as the definition of change of use, deemed disposals, how the change of use legislation interacts with existing ring fence provisions and so on. However, at the time of writing, no further changes are expected in the near future.

The change of use measures introduced by Finance Act 2009 have effect for ring fence expenditure (for CT purposes) incurred after 21 April 2009 and for PRT purposes for chargeable periods beginning on 1 July 2009.

Corporation tax

16.13 Where a ring fence trade has ceased and the associated ring fence assets are decommissioned, the resulting costs which are incurred subsequently can be allocated to the last trading period and any resulting losses carried back as described in paragraphs 13.3 - 13.8. The new change

of use rules introduced by Finance Act 2009 allow companies the same treatment when former ring fence assets are decommissioned after they have ceased to be used in the change of use activity (to the extent that activity is in the UK North Sea). In this way, when oil and gas production ceases and the former ring fence assets are used in a different capacity (eg carbon capture, gas storage etc) when they are finally decommissioned from that change of use activity that decommissioning expenditure can be relieved (primarily via capital allowances) against the former ring fence profits and carried back as if a ring fence loss.

Petroleum revenue tax

16.14 Prior to FA 2009, when a PRT asset is used for a non-PRT activity (ie a change of use activity), part of the cost previously relieved for PRT is clawed back. Furthermore, the use of a PRT asset for a change of use activity could have resulted in tariff income subject to PRT. FA 2009 removes the above clawback to the extent the asset is used wholly for a change of use purposes and removes income, arising from change of use operations, from the scope of PRT. In addition, FA 2009 allows for PRT relief on decommissioning expenditure even if the assets have been used for a change of use activity (previously relief was denied if an asset was used for a non-PRT purpose.)

Gas storage - cushion gas

Section 104A(1)(f) CAA 2001

16.15 In gas storage operations it is normal to require a certain level of gas to maintain pressure and the viability of the reservoir/cavern. HMRC have agreed that such cushion gas (albeit that the constituent elements will change over time) performs a specific function and expenditure on such qualifies for capital allowances as plant and machinery. Cushion gas qualifies for allowances at a rate of 10 percent per annum (8 percent from April 2012). Discussions continue on the tax treatment of other costs associated with preparing the storage facilities for gas storage use.

Part 5 - Non-resident Contractors and Personal Tax

Chapter 17

Taxation of non-resident contractors

17.1 As the pace of offshore exploration and development quickened, it became apparent that considerable profits were being made by non-resident contractors providing services to the offshore oil industry. As a result, special rules were enacted by section 38 FA 1973 to bring such persons into charge to UK tax. The rules regarding the taxation of trading profits are now consolidated at section 1313 CTA 2009 (previously section 830(1) ICTA 1988), and the capital gains rules at section 276 TCGA 1992.

17.2 Activities carried on in the UK territorial sea (being broadly 12 miles from the low water mark) are to be treated in exactly the same way as onshore activities.

Scope of section 1313 CTA 09

17.3 So far as the "UK sector of the continental shelf" (the term previously used was "designated area" but both refer to the same definition source) is concerned, a slightly different approach is adopted because the rights which the UK has over these areas fall short of full sovereignty. The overall effect is to create a tax charge for non-resident contractors. Income from exploration or exploitation activities, or from exploration or exploitation rights, is treated as income of a trade carried on through a branch in the UK and hence becomes subject to CT.

Section 1313(2) CTA 09

17.4 Exploration or exploitation activities means activities carried on in connection with the exploration or exploitation of so much of the seabed and subsoil and their natural resources as is situated in the UK or the UK sector of the continental shelf. This charge therefore applies to all natural resources and not just to oil. It is limited in two significant ways:

(a) It only applies to exploration or exploitation of the seabed and subsoil situated in the UK designated area. Activities carried on in the UK sector

of the continental shelf but relating to oil from fields outside the UK are not within the section.

(b) The charge only applies where such activities are actually carried on in the UK or the UK sector of the continental shelf. Activities carried on abroad but relating to these areas are not within the charge: thus, a Norwegian shipyard building a rig for the use of a UK oilfield is not within section 1313. Difficulties can arise in these provisions where facilities are shared between two fields in two territories, or where a single field enters into two territories.

17.5 Exploration and exploitation rights are defined as rights to assets to be produced by exploration or exploitation activities. It is considered that this definition extends to licence rights but, in view of the future tense, does not extend to other assets – e.g., ships or rigs used in connection with the oil industry.

Section 276 TCGA 92

17.6 Contractors may be brought within the charge to tax on capital gains for disposals, after 12 March 1984, of exploration and exploitation assets situated on the UK Continental Shelf (Paragraph 14.2). They will also, like anyone else, be within the scope of the charge in respect of gains on the disposal of exploration and exploitation rights or of unquoted shares deriving the whole or greater part of their value from such rights.

17.7 In some cases difficulties can arise in deciding:

(a) whether a function is one defined in section 1313;

(b) whether it is carried on in the UK or UK Continental Shelf.

An example of this problem would be the construction abroad of an item for use in the UK North Sea, but which involved sending personnel to the UK sector to assist with completion and installation. A more celebrated example is the conclusion abroad of a bareboat charter of a drilling rig.

It might be thought that a bareboat charter of a rig in such circumstances would neither be an activity nor, if an activity, carried on in the UK or Continental Shelf. HMRC has issued a Statement of Practice (SP 6/84) which sets out certain conditions to be satisfied before they will agree not to invoke section 830 in leasing operations such as this (it is assumed that this will now apply to section 1313). However, there are many circumstances which strictly fall outside the Statement of Practice but where it could well be contended that section 830/1313 does not apply.

Enforcement of section 1313 CTA 2009

17.8 A company chargeable under section 1313 CTA 2009 must (like any other taxpayer) give notice of chargeability to HMRC within one year after the end of the accounting period.

Schedule 18
Para 2
FA 1998

17.9 The Board of HMRC has power to obtain information from the holders of any licence regarding:

- transactions in connection with activities authorised by licence as a result of which any person might be liable to tax by virtue of section 1313 CTA 2009 or section 276 TCGA 1992;
- emoluments or other payments made in respect of duties or services performed in the licence area.

A person served with a notice must take reasonable steps to obtain the information necessary to comply. In practice, the information is generally required by HMRC from the operator, and in respect of persons appearing to be non-resident. They ask for details of sub-contractors and their employees, as well as of direct payments by the operator.

17.10 Where a non-resident is assessed to tax under section 1313 CTA 09 and the tax remains unpaid for more than 30 days after it becomes due and payable, the Board of HMRC may require payment of tax and interest from licensees. Payments made by a licensee under these provisions are not deductible for any tax purposes.

Schedule 15
FA 73

17.11 The non-resident contractor may apply for an exemption certificate such that the licensee is assured that it will not be held liable for any tax assessed on the contractor. If the application is successful, the certificate is sent to the licence holder. The use of such certification is limited by the fact that the certificate can be revoked, but not within 30 days from the date of issue.

17.12 The rules for interest on overdue tax are complex and are not discussed here. In some cases interest can run from a date before that on which the Board of HMRC assesses the liability. It is therefore in the taxpayer's interest to make returns on a timely basis. Interest on overdue tax is not deductible for tax purposes if in respect of accounting periods ending on or before 30 June 1999. Interest on overdue tax arising in respect of accounting periods ending after 30 June 1999, is deductible for tax purposes.

Treaties

17.13 It is possible that a contractor who is within the charge to UK tax under section 1313 CTA 2009 may be protected by a double tax treaty. In order to claim the benefit of a treaty, a contractor must be a resident (as defined in the relevant treaty) of a territory covered by a double tax treaty in force with the UK. For this reason, companies incorporated and/or resident in tax havens frequently obtain no relief.

17.14 The Treaties may be divided into three broad categories:

(a) Those with a 'restricted definition' of 'the UK' i.e., excluding the UKCS;

b) Those with an 'extended definition' of 'the UK' i.e., including the UKCS, but without an Offshore Activities Article; and

(c) hose with an 'Offshore Activities Articles' i.e., those which determine certain activities to be carried on through a UK permanent establishment and an extended definition of the UK.

17.15 Older treaties sometimes retain a restricted definition of the UK which does not include the UK sector of the Continental Shelf. It follows that profits earned by a resident of such a treaty territory from UK sector activities will not be subject to UK tax, provided there is no UK shore base, since there will not be any permanent establishment in the UK as defined.

17.16 More recent treaties include the Continental Shelf within the UK. However, a resident of such a treaty territory will only be subject to UK tax if he has a permanent establishment, as defined in the treaty. Where the particular contractor is involved offshore for a short time on a one-off basis, it is fairly clear that there is no permanent establishment. Where a contractor is involved on a larger scale, or for longer periods, the position is not so clear. One instance is known where it has been held by the Special Commissioners that a mobile semi-submersible drilling rig did not constitute a permanent establishment, although HMRC consistently argues that drilling rigs are permanent establishments. The treaty definition of a permanent establishment is not generally very helpful on this point.

17.17 It should be noted that certain treaties have resolved the problem by specific provision in an 'Offshore Activities Article' that exploration and exploitation activities should be regarded as carried on through a permanent

establishment. Examples are treaties with Ireland, United States, Netherlands, Sweden, Norway, New Zealand, Canada, France, Denmark, Finland, Italy, Belgium, Falkland Islands, Isle of Man and Lithuania. Thus contractors resident in these territories are subject to UK tax. Exceptions to note are that under the United States, Norway, Canada, Netherlands, Falkland Islands, Isle of Man, Lithuania, Sweden and France treaties, treaty protection still applies, provided UK and Continental Shelf activities do not total more than 30 days in any 12 months.

Other exceptions include:

(a) United States – Supply vessels continue to benefit from the shipping article.

(b) Norway – Profits from supply, tug and similar boats are taxable only where the operator is resident.

17.18 One possible method of treaty relief, which is not relevant to most contractors, is the 'shipping article' of the relevant treaty. Such an article may apply where ships are in use for offshore work – e.g., the supply of workboats, or where rigs or drill ships are regarded as ships. Newer treaties generally only give relief where the vessel is in international traffic. This would prevent relief for most types of offshore work.

However, older treaties do often give relief for shipping regardless of whether the vessels are employed in international traffic.

17.19 More usually, relief may be available under the business profits article. Potentially, this can apply to any contractor. Such articles generally provide that the UK may only tax such profits as are derived from a permanent establishment in the UK.

Computation of profits of non-resident contractors

17.20 The starting point will be the profit as stated for accounting purposes. This is then adjusted for items which are treated differently for tax purposes. The basis of computation will differ, depending on whether there is a liability based on a UK permanent establishment, or merely one based on section 1313 CTA 2009. Generally, the main differences will be that on a section 1313 basis capital gains (other than in respect of licence rights, exploration or exploitation assets or unquoted shares deriving their value therefrom) are not chargeable.

17.21 In the absence of specific branch accounts, it is necessary to extract income and expenses relating to UK operations and prepare computations for these. Difficulties can arise on allocation of interest costs, office overheads and similar items.

Commencement and cessation

Section 41 CTA 09

17.22 A company going into, or out of, charge to UK tax is treated as commencing or ceasing to trade.

Section 61 CTA 09

17.23 In measuring the income of a non-resident contractor this gives rise to difficulties, as on general grounds the income earned by a UK contract will require to be matched against its costs. Such costs may be incurred both before and after the particular operation is carried on in the UK, and could thus technically be incurred either before commencement or after cessation of trading. Examples may be mobilisation costs of any rig brought to the UK sector or warranty payments made after the conclusion of a contract. HMRC generally suggests that these are not deductible. However, the special rules for pre-trading expenses (Paragraphs 11.5 to 11.6) should assist on pre-contract expenses. Equally, where a treaty applies, the 'non-discrimination' articles might assist. Where operations are carried on intermittently in the UK or Continental Shelf, with idle periods and work elsewhere intervening, a reasonable basis of allocating expenses will need to be agreed with HMRC. The OECD Commentary provides guidance on this issue, suggesting a 'just and reasonable' apportionment by reference to turnover, gross profits or expenses and labour costs depending on the facts of the case.

Transmedian line fields

17.24 Difficulties arise where contractors are engaged in transmedian line fields. The various protocols relating to production from fields do not apply to contractors. It is therefore necessary for these to be dealt with on general principles.

17.25 The scope of section 1313 CTA 2009 is such that there is liability for work performed inside the UK sector of the Continental Shelf if it relates to UK resources, but not if it relates to non-UK resources. There is no liability at all for work performed outside the UK sector. Accordingly, allowance for both these factors must be made in computing the profits of contractors for tax purposes. The exact method of computing these factors may give rise to difficulty where

it is not possible to apportion exactly the work done in the different sectors, or to apportion the work done between the territory resources to which it relates.

Capital allowances

17.26 A continuing area of difficulty is the treatment of capital allowances for large items – e.g., drilling rigs or specialised boats, such as pipe-laying barges. The legal provisions do not deal adequately with all the possibilities. The following practice is adopted, although it must be appreciated that there are variations to meet particular cases.

S206 CAA 2001

17.27 Where the asset does not enter and leave the UK frequently, capital allowances operate in the normal way. If the asset may be classed as a ship – e.g., a drillship – free depreciation (Paragraph 12.31) may be available (prior to 1 April 1985, only if the asset is new). If the asset is not new to the owner, market value may be treated as the basis for allowances. When the asset is sold, or finally leaves the UK sector ('final' meaning, in the view of HMRC, an absence of at least two years and, more probably, three or four years), a balancing adjustment will be made by reference to sale proceeds or market value respectively, but not so as to claw back more than the total allowances given.

S61(1) CAA 2001

17.28 It will be appreciated that where an asset is relatively new the allowances may well eliminate taxable profits. Equally, where the asset is not new and comes to the UK, allowances may be very low, and taxable profits may well exceed commercial profits. Because the other activities of the contractor are outside the UK tax net, there is not the scope, as there is for a UK-based taxpayer, to cover such profits with allowances from other assets.

Sub-contractors in the construction industry – Construction Industry Scheme

17.29 The deduction at source provisions relating to the above may apply to the onshore activities of oil companies and contractors, and to activities within the 12-mile limit. HMRC believe, in principle, that the provisions can also cover activities on the UK Continental Shelf, but in practice they do not apply them there.

Chapter 18

Income tax for Individuals, PAYE and NIC

UK-resident and ordinarily resident individuals

18.1 Section 41 ITEPA 2003 treats emoluments from an office or employment in respect of duties performed in the UK Continental Shelf in connection with exploration or exploitation activities as emoluments in respect of duties performed in the UK.

Benefits in kind: travel expenses

Section 305 ITEPA 2003

18.2 Workers on offshore oil and gas rigs or platforms are usually transferred between the mainland and the rig, etc at their employers' expense. The cost of transfer transport (being transport by sea or air between the mainland and the offshore installation), related accommodation and subsistence and local transport will not give rise to income tax. This provision does not, however, extend to the cost of providing free travel between an employee's home and the UK mainland point of departure but does specifically cover local transport (e.g., hotel to heliport travel was not previously addressed by ESC A65 2003).

Sections 369 & 370 ITEPA 2003
Sections 373 & 375 ITEPA 2003

18.3 Taxable benefits can similarly arise in respect of overseas travel expenses. However, in certain circumstances, where the duties of the employment are performed wholly or partly abroad, an unlimited number of journeys may be made to and from the UK without giving rise to a tax liability. Similar principles apply to the self employed where working wholly and exclusively abroad. Relief for travel expenses for expatriate employees working in the UK may also be available, but it is limited to a five-year period from the employee's arrival in the UK.

Treaty relief for foreign residents

18.4 If a person is regarded as resident in a territory outside the UK for the purpose of the tax treaty between the UK and that territory, he may then obtain relief from UK tax in respect of duties performed in the UK or its Continental Shelf. Treaties vary, but a typical modern treaty would give relief from UK taxation if:

(a) the employer is not a resident of the UK; and

(b) the emoluments are not borne by a permanent establishment which the employer has in the UK; and

(c) the employee is not in the UK, as defined for the purposes of the treaty, for more than 183 days in any one tax year.

18.5 It should be noted that the question of whether or not a foreign employer has a permanent establishment in the UK is a question of fact.
Thus, where an employer is a non-resident contractor, relief from UK tax may be available if he does not have such an establishment.

18.6 HMRC takes the view that the mention of 'employer' in the employment income article of a double tax treaty refers to the employee's economic employer – which is not necessarily the employee's contractual employer. This is a complicated matter and there are numerous factors that need to be taken into account when examining whether an entity in the UK might be the economic employer of an employee contractually employed by an entity outside the UK. The danger of this being the case is increased if the employee's costs are borne, in any way, by the UK entity. However, this is not the sole determining factor and it would be advisable to seek professional advice if substantial amounts revolve around the issue. HMRC have stated that a UK entity is unlikely to be the economic employer of an employee contractually employed outside the UK if the time spent by the employee in the UK is less than 60 days in the UK tax year, and that period does not form part of a more substantial period when the employee is present in the UK.

18.7 Older double tax treaties may apply less stringent criteria for relief and therefore the terms of the particular double tax treaty should be considered carefully. Income tax for individuals and PAYE.

18.8 Under certain treaties, the relief set out at 18.4 above does not apply as there is a specific article relating to offshore activities. For example, under the UK/Norway treaty, duties of individuals in relation to exploration or exploitation activities in the Continental Shelf are specifically subject to UK tax. Other treaties (see Paragraph 17.17) which widen the definition of a permanent establishment from the point of view of computing business profits, do not appear to affect the UK tax position of foreign resident employees.

18.9 Sailors and airline employees may be subject to special treaty rules, subject to the time spent in the UK.

Determining UK residence

18.10 It should be noted that, in determining whether a person is resident in the UK for tax purposes, days spent in the Continental Shelf outside the 12-mile limit do not count as days spent in the UK. This may be helpful in cases where duties are performed both inside and outside the UK and Continental Shelf, removing the employee to the less stringent position of being either not resident or not ordinarily resident.

18.11 The 100 percent deduction previously available against employment earnings for UK residents spending certain periods abroad was withdrawn from 17 March 1998. However, the deduction was retained for seafarers and may now even apply to non-resident seafarers who are resident in another EEA member state.

PAYE

18.12 Pay As You Earn (PAYE) regulations require withholding of income tax from salaries to be operated by employers where the employees concerned are liable to UK income tax. HMRC takes the view that this applies even when the employees work outside the UK. Following the decision in the House of Lords in the case of Oceanic Contractors v. Clark [1983] STC 35, it would appear that PAYE must be applied wherever the employer has sufficient tax presence in the UK. Further, ITEPA 2003 extends the operation of PAYE to an employer where an intermediary makes a payment on account of assessable income to an overseas employee on behalf of that employer and can, in certain circumstances, require a person to pay tax to the UK authorities in respect of an individual working for that person, even though the individual is employed and paid by a third party.

NIC

18.13 A person employed in the UK will pay national insurance contributions (NIC) on their earnings where the employee either:

SSCBA 1992

SS (Contribution Regulations 2001)

- holds a contract of service for a UK employer, or
- is based in a UK situated office where earnings are chargeable to UK income tax.

18.14 14 For employees in the oil industry it can be difficult to determine if they are working in the UK or not as most of the work takes place at the Continental Shelf. As the Continental Shelf is outside the territorial waters of the UK, employment there is not considered employment in the UK.

18.15 However, anyone who is employed in connection with the exploitation of resources in an area of the Continental Shelf, and where their employment is in connection with a chargeable oil activity, will be treated for contribution purposes as if those areas are in the UK. This means that oil rig workers are liable to NIC in the UK.

18.16 Many individuals who work on the Continental Shelf are also classed as mariners for whom different rules apply. Where the contractual employer is resident outside the UK, in these circumstances employers' secondary national insurance may not be due (see 18.17 below regarding the implementation of the revised European Union regulations) unless there is a UK host employer with a place of business in the UK.

18.17 The new European Union regulations covering European social security were adopted by the EU in 2004 and 883/2004 will come into force in the UK on 1 May 2010. This will replace EC regulation 1408/71 and covers individuals posted within EU states. This can be complicated and requires more explanation than is within the scope of this book. Regulation 1408/71 will continue to apply to third country national, EEA countries, Switzerland and Greenland.

EC 1408/71

EU 883/2004)

18.18 In practice this area is very complex. However, detailed discussion of these provisions is beyond the scope of this book.

Divers

Section 15 ITTOIA 2005

18.19 Divers and their supervisors are taxed on UK and Continental Shelf activities as if self-employed, even where they are technically employees. This results in a more generous regime for deducting expenses, but little other advantage. These special rules do not apply to work carried out abroad, nor do they apply for NIC purposes.

The self-employed

18.20 A non-resident coming to the UK to do a job in the Continental Shelf will be taxed on UK work, regardless of whether or not he becomes UK resident. If he becomes UK resident, he will be subject to tax on his worldwide income for the year of assessment in which he is UK resident (though different provisions apply to partnerships). The computation of taxable income will be on the lines of those described in the preceding chapter for other non-resident contractors, except that an individual will be charged to income tax rather than corporation tax. An individual would generally be liable to tax on profits of accounts ending in the current tax year. For years prior to 1996/97, the basis of assessment was on the accounts ending in the previous tax year. There are supplementary rules covering the years of commencement and cessation of the business.

18.21 Tax relief may be available assuming the individual is a tax resident in the treaty partner country. Generally, where a treaty applies, there will be no UK tax liability if the individual concerned does not have a permanent base available to him in the UK, as defined in the treaty, and does not spend more than 183 days in the UK in any tax year. Where the latter provision is relevant, presence in the UK Continental Shelf will count against the taxpayer if the treaty has the broad definition of the UK, but not otherwise. The concept of a permanent base is similar to that of permanent establishment, but is generally less well defined.

IR35

18.22 From 6 April 2000 HMRC introduced rules concerning the taxation of workers who provide their services to clients through intermediaries, such as personal service companies. Separate Social Security Regulations which introduce the same rules for National Insurance Contributions (NICs) were also tabled.

18.23 The rules use existing case law to define an employee and determine that, where workers meet that definition in relation to work done for their clients they will pay broadly the same tax and NICs as an employee, even if they provide their services through an intermediary.

Managed Service Companies (MSCs)

18.24 From 6 April 2007, workers who provide their services to clients via a "managed service company" are subjected to PAYE and National Insurance contributions, broadly as if employed. This is on top of the IR35 legislation referred to above. The definition of "managed service company" is not straightforward. Broadly, it is a company which is not controlled by the worker, and that company is involved with a MSC provider. A MSC provider is defined as a person who carries on a business of promoting or facilitating the use of companies to provide the services of individuals. In addition, in certain circumstances the PAYE and NIC debts of MSCs can be transferred to third parties.

Social Security Contributions (Managed Service Companies) Regulations 2007)

Appendix I

PRT-allowable field expenditure

(See Paragraph 5.3)

Searching for oil

Section 3(1)(a)

I.1 This heading includes searching for oil anywhere within the area of a field as subsequently determined, or not more than 5,000 metres beyond its boundary. The 5,000-metre limit recognises that the search area may be larger than that of the field as determined. In the Special Commissioners' decision in Amerada Hess v. CIR [2000] the Revenue lost an attempt to apply a purposive approach and contended that a claim should fail if not incurred for a 'field purpose'. The Special Commissioners said, '…we have come to the conclusion that... we should accept a literal construction of section 3(1)(a) and the consequence that the determining factor is geographical not geological.'

Licence payments (other than royalties or rentals)

Section 3(1)(b)

I.2 Payments to the Secretary of State for the purposes of obtaining a licence, whether by way of premium or auction fee, are allowed under this heading. Royalties and licence rentals are taken into account in computing licence debit or credit.

Delineation

Section 3(1)(c)

I.3 This includes the cost of ascertaining the extent and characteristics of any oil-bearing area wholly or partly included in the field, or the reserves of oil of any such area. In practice it may be difficult to ascertain whether certain costs can be said to be those for searching or delineation. Since expenditure allowed under this heading does not have to relate to areas falling within the field, it may be possible to obtain relief for expenditure which would otherwise be disallowed by the 5,000-metre limit.

Winning oil

Section 3(1)(d)

I.4 This will be the principal item of expenditure and will include all the costs of developing the field, putting it into production and running it.

Measuring the quantity of oil

I.5 This item covers measuring the quantity of oil won, or to be won, from the field.

Section 3 (1)(e)

Transporting oil to land

I.6 Where oil is won offshore, a deduction is allowable for the cost of transporting it to the place where it is first landed in the UK, or (to cover the case where an offshore pipeline might run some distance onshore before it reaches the terminal facilities) to the nearest place in the UK to which the seller in an arm's length sale could reasonably be expected to deliver it.

Section 3(1)(f)

I.7 For claim periods ending after 27 November 1991, the costs of transport to non-UK locations are also allowed. The provision takes the same form as for UK landings, so that it is the costs to the place of delivery or to a location where delivery could reasonably have been expected to be made (if less) that are allowable. This effectively formalises a concession operated by HMRC before that date in relation to tanker loading fields and extends it to cover export by pipeline.

Section 74
F(No.2)A 92

I.8 No transportation costs are allowable for oil won onshore.

Initial treatment or storage

I.9 Expenditure allowed under this heading is restricted in scope. Initial treatment in relation to oil from an oil field means:

Section 3(1)(g)
Section 12(1)

(a) any process, the sole purpose of which is to permit oil to be safely stored, safely loaded into a tanker, or safely accepted by an oil refinery; or

(b) separating gas from oil; or

(c) fractionation of gas; or

(d) liquefying gas for transport; or

(e) treatment to bring oil up to the normal quality of crude oil from the field.

It does not include:

(i) storage (even if this involves initial treatment); or

(ii) any activity which is part of, or associated with, refining oil or, where gas is concerned, the sole or main purpose of which is to achieve a chemical reaction; or

(iii) deballasting.

I.10 Initial storage means the storage of oil won from the field. In the case of storage on land, it is limited to a quantity equal to ten times the maximum daily production rate of oil for the field as planned or achieved (whichever is greater). It does not include:

(a) storing of oil as part of, or in conjunction with, the operation of an oil refinery; or

(b) deballasting; or

(c) conveying oil in a pipeline.

I.11 For claim periods ending after 27 November 1991, F(No2)A 1992 abolished the requirement that the initial treatment or storage must take place in the UK or its Continental Shelf.

Sale of crude oil at arm's length

Section 3(1)(h)

I.12 A The expenses of disposing of crude oil are allowed where the disposal is a sale at arm's length, but not otherwise. Since many disposals will be treated as otherwise than sales at arm's length, the application of this provision is somewhat limited.

Obtaining an abandonment guarantee

Section 3(1)(hh)

I.13 Expenditure on obtaining an abandonment guarantee is allowable subject to certain conditions. An abandonment guarantee is a contract (including, for example, a letter of credit) under which the guarantor undertakes to make good any default by a participator on his liability (under a joint operating agreement or a unitisation agreement) for the cost of closing down all or part of a field. Restrictions apply in relation to the commerciality of the guarantee and whether it is made at arm's length. Provided that the participator is required to provide such a guarantee, he will be allowed a deduction for the fees, commissions and other incidental costs of obtaining it.

Section 104
FA 91

I.14 If the guarantor has had to make payments under such a guarantee, any amounts which the participator then reimburses to him under the obligations imposed by the guarantee will themselves be regarded as qualifying expenditure in obtaining an abandonment guarantee, though only to the extent that they represent expenditure allowable under section 3 OTA 1975.

Section 103(5)
FA 91

I.15 A Expenditure under the provisions outlined in Paragraphs I.13 and I.14 is allowable to the extent that it is incurred after 18 March 1991.

No similar expenditure was allowed prior to that date.

Abandonment costs

I.16 Expenditure incurred after 30 June 1991 on closing down, decommissioning, abandoning or wholly or partially dismantling or removing any qualifying asset will be allowable. Decommissioning costs include the costs of restoring qualifying assets which have been leased or hired. Qualifying assets are as defined in OTA 1983 (Paragraph 4.31). Where assets have been used in more than one taxable field, the costs must be apportioned. Where they have been used otherwise than for a taxable field, an appropriate proportion of the costs used to be disallowable.

Section 3(1)(i)
Section 3(1A)

I.17 For expenditure incurred from 22 April 2009, use, otherwise than for oil production, will not result in a disallowance, subject to certain restrictions.

I.18 Before the new legislation introduced by FA 1991, the only costs allowable in relation to abandonment were those incurred on the abandonment itself. However, the rules were much more tightly drawn than now: expenditure was allowable where incurred on closing down the field or any part of it, but only if and to the extent that the expenditure was incurred for the purposes of safety or the prevention of pollution. There were no provisions regarding abandonment guarantees, site restoration, or meeting the expenditure of a defaulting participator.

Section 3(1)(j)
Section 3(1B)

Site restoration work

I.19 Qualifying restoration work incurred after 30 June 1991 on the closing down of a taxable field or part of it is allowable expenditure. Qualifying restoration work includes:

(a) restoring (including landscaping) land on which a qualifying asset is or was situated; and

(b) restoring the seabed on which a qualifying asset is or was situated.

Para. 2A
Sch. 5
Section 108
FA 91

A qualifying asset is as for Paragraph I.16.

Meeting defaulter's abandonment expenditure

I.20 Relief is available to a participator (the 'qualifying participator') where another participator in the field defaults on his obligation to make payments which would qualify for relief under Paragraphs I.16 or I.18 above, despite all reasonable steps having been taken to enforce his obligation and the terms of any abandonment guarantee. From 1 July 2008, relief is also available to

a former participator. Where, after 30 June 1991, the qualifying participator is obliged to make good these payments, and does so, he may take a PRT deduction for the amount.

I.21 Where Paragraph I.20 has applied, and the defaulting participator subsequently reimburses the qualifying participator for the expenditure, then:

(a) the defaulter will be treated as having incurred allowable expenditure under Paragraph I.16 above; and

(b) the qualifying participator will include the receipt in the positive amounts included in his calculations of assessable profit or allowable loss.

Reimbursement expenditure will only be so treated to the extent that it does not exceed the payments made by the qualifying participator relating to the default.

Statutory redundancy payments

Section 3(2)

I.22 Where the field is active, such costs would normally qualify under one of the other headings. This category permits statutory redundancy payments to be deducted where the field is being, or has been, closed down.

I.23 From 1 July 2009 expenditure on earning tariffs otherwise than from oil production will be allowable. Previously it was not.

Earning tariffs

I.24 To the extent that an asset is used for earning tariffs, the attributable expenditure is allowable. Special rules apply if the expenditure was incurred solely for the purposes of earning tariffs. Typically, tariffs will arise from the use of field production facilities and pipelines.

Appendix II

PRT expenditure – restrictions

(See Paragraph 5.6)

Excluded expenditure

Interest

II.1 Interest or any similar payment is not allowed but, as mentioned in Paragraph 5.17, uplift of 35 percent applied to qualifying expenditure is intended to replace this.

Section 3(4)(b)
Section 3(4)(c)

Land

II.2 Costs of land or any interest in land are excluded. Where shore bases have been acquired in remote areas, possibly at high prices which will not be realised on ultimate disposals, no relief will be available.

Section 3(4)(b)
Section 3(4)(c)

Building onshore

II.3 The cost of acquiring or erecting a building or structure on land is excluded, unless the expenditure is on a structure or building which is:

Section 3(4)(c)

(a) subsequently to be placed on the sea bed; or

(b) to be used for winning or measuring oil from beneath land; or

(c) to be used for initial treatment or initial storage; or

(d) to be used to transport offshore oil from the place of first landing to the place in the UK or (for chargeable periods ending after 27 November 1991) in any other country where the seller in an arm's length sale could reasonably be expected to deliver it or, if there is more than one, the place nearest the place of extraction.

Expenditure determined by reference to production from or profitability of the field

II.4 Any expenditure wholly or partly depending on the quantity, value or proceeds of, or profits from, oil is disallowed. The apparent purpose of these provisions is to simplify collection of the tax by ignoring fragmentation of profits which may arise under various royalty and other agreements.

Section 3(4)(d)

Payments to obtain interest in licences or production other than to the Secretary of State

Section 3(4)(e)

II.5 Any payment made to acquire a direct or indirect interest in oil won from a field is disallowed, unless made to the Secretary of State. Where a licence has been acquired by assignment, the consideration given would not be allowable for PRT. However, the assignee would normally obtain relief for the predecessor's unallowed expenditure or unused losses. This would frequently be less than the assignment cost.

Payments to discharge tax liabilities of non-resident contractors

Section 3(4)(f)

II.6 HMRC may have recourse to licensees for unpaid tax assessed on non-resident contractors (Paragraph 17.10). Payments by licensees of such liabilities are disallowed.

Payment received under an abandonment guarantee

Section 105 FA 91

II.7 Where expenditure is met out of a payment received under an abandonment guarantee (Appendix I.13-I.15), it will not be regarded as allowable expenditure of any participator in the field.

Tariff payments to non-taxable fields

Section 193(2) & (3) FA 1993

II.8 In certain circumstances, a participator in a taxable field cannot obtain PRT relief for payments which he makes to a connected person who is a participator in a non-taxable field. The circumstances are that, if the non-taxable field had been taxable, the sums would have constituted tariff receipts (Paragraph 4.29) or disposal receipts (Paragraph 4.49) in the hands of the recipient.

Expenditure not at arm's length

Para. 2 Sch. 4

II.9 Prior to 17 March 2004 where expenditure resulted from transactions with connected persons as defined in section 1122 CTA 10, it was only allowable to the extent that it did not exceed cost to the connected person. Cost was specifically stated to be exclusive of interest or associated charges. Where an asset was hired from a connected person who was the owner, it was arguable that no restriction would accrue until the hire payments equal the cost of the asset.

FA 2004

II.10 FA 2004 amended the rules on relief available in the case of transactions between connected parties to bring the rules more into line with general transfer pricing principals. For expenditure incurred on or after 17 March 2004, the allowable amount is restricted to the lowest of:

Para. 2(1ZA) Sch. 4

(a) the historic cost of the asset or service to the group;

(b) the open market value; or

(c) the amount chargeable to PRT as a disposal receipt on the other party to the transaction.

Subsidies

II.11 The amount of allowable expenditure is to be reduced by any subsidies received. This provision extends to regional development grants so that, in distinction to the position under general tax law, expenditure met by such grants is not deductible in computing PRT or ring fence capital allowances. This provision only applies to expenditure incurred after 9 March 1982 and where the grant is paid after that date (Paragraph 12.41). The proceeds of insurance claims which are not treated as disposal proceeds of long-term assets are generally treated as subsidies.

Section 137 FA 82 Para. 8 Sch. 3

Apportionments of expenditure

II.12 No expenditure will be allowed for a non-taxable field and therefore, where expenditure relates to taxable and non-taxable fields, apportionment will be required.

Section 185(6) FA 93

II.13 Expenditure may not be allowed for any field if, or to the extent that, it has previously been allowed for any other field.

Section 3(3)

II.14 Expenditure incurred partly for a purpose qualifying for basic relief or uplift and partly not, should be apportioned as is just and reasonable.

Section 3(6)

II.15 Expenditure incurred by any person may not be allowed for a field if expenditure previously incurred by another person on the same asset is allowable for that field. This same provision is extended to apply to interests in assets as well as to whole assets, and to all business transactions. Its operation in relation to assets bought at one time and hired at another is unclear.

Para. 1 Sch. 4 & Section 4(13)

Expenditure allowable where production commenced before 13 November 1974

Para. 3 Sch. 4

II.16 In the rare cases where oil began to be won in commercial quantities before 13 November 1974, and is not excluded from the charge by the special provisions relating to natural gas, expenditure incurred before that date is only allowed to the extent that it could broadly be described as capital expenditure.

Appendix III

Exploration and appraisal expenditure

III.1 Until it was abolished by FA 1993, some form of relief had always been available against field profits for exploration expenditure unconnected with the field. The history of the relief has been as follows:

Section 5
Section 5A
Section 90(2)
FA 85
Section 188
FA 93
Section 113
FA 84
Section 107
FA 97

- UK onshore and offshore exploration expenditure incurred between 1 January 1960 and 15 March 1983 could qualify for relief only if it proved abortive (Paragraphs III.13-III.15).
- For expenditure incurred between 16 March 1983 and 31 March 1986, onshore or offshore UK, the relief was extended to cover appraisal costs and was available whether or not the exploration and appraisal (E&A) was successful.
- As from 1 April 1986, onshore E&A expenditure ceased to qualify for the relief.
- Subject to certain transitional provisions set out below (Paragraphs III.2-III.5), E&A relief is not available for expenditure incurred after 15 March 1993. In all cases, the relief does not apply to expenditure incurred prior to the company becoming a participator in the taxable field against which it is sought to relieve the expenditure, where that field interest was acquired by the company after the end of that field's first chargeable period and after 13 September 1983. Expenditure incurred in relation to a field after a field development has been approved for that field could not qualify. Consent to a well test is not regarded as a development approval.

In addition, relief is not available for non-field expenditure originally incurred by an unrelated group of companies which continue to hold licence interests in the North Sea.

III.2 E&A expenditure could continue to qualify for relief if it was incurred within the two years beginning on 16 March 1993, provided that the expenditure was committed to before 16 March 1993.

Section 188(1)
FA 93

Section 188(2) FA 93
Section 189 FA 93

III.3 A commitment to expenditure existed where either:

(a) there was an obligation to incur the expenditure under an E&A contract entered into before 16 March 1993; or

(b) a contract under (a) above already existed, and there was an obligation under a further contract to incur expenditure wholly and exclusively for the same purpose as the first; in this case, the second contract had to have been entered into before 16 June 1993. This could allow full relief in a case where, for example, only some of the contracts necessary for the drilling of an exploration well had been put in place before 16 March 1993.

Section 189 FA 93

III.4 However, a person was not regarded as committed to any expenditure under such contracts to the extent that either he could avoid it by invoking a break clause or he would incur it only as the result of exercising an option after 15 March 1993.

III.5 Transitional relief was also available for E&A expenditure up to a ceiling of £10 million where the expenditure was incurred after 15 March 1993 and before 1 January 1995. This was in addition to any relief given under Paragraphs III.2 to III.4. Where there was more than one company in a group with such expenditure a single £10 million aggregate limit applied for all of them.

III.6 To qualify for E&A relief, expenditure after 31 March 1986 had to be incurred wholly and exclusively for one or more of the following purposes:

(a) searching for oil in the UK territorial sea or Continental Shelf; or

(b) certaining the extent or characteristics of any oil-bearing area in the UK territorial sea or Continental Shelf; or

(c) ascertaining the oil reserves of any oil-bearing area in the UK territorial sea or Continental Shelf; or

(d) obtaining a licence from the Secretary of State (i.e., licence premium or auction payments).

Section 108 FA 86

The expenditure in (a), (b) and (c) is also allowable if incurred in relation to onshore exploration in the UK prior to 1 April 1986. No claim may be made under (d) until the licence has expired or been determined or revoked. If part of the licence area has been surrendered, a proportionate amount is allowable. With effect from 1 April 1986, certain areas of sea between the baseline of the territorial sea and the UK coastline, which would otherwise be regarded as onshore UK, was deemed to be part of the territorial sea for PRT purposes.

One of the main effects of this was to preserve the availability of relief for E&A expenditure in these areas after March 1986.

III.7 No part of expenditure claimed under these provisions qualified for uplift.

III.8 Expenditure previously allowed in any way for PRT could not be claimed under these provisions. A claim under these provisions does not in principle bar a later claim against any successful taxable field which results from the exploration or appraisal expenditure unless the claimant is the same person, though it is not clear that such a later claim would succeed in practice.

Section 5A(6)
Section 3(3)

III.9 Special provisions, similar but not identical to those applying to other expenditure, exist in respect of:

(a) long-term assets; — Section 5(2)

(b) receipts arising from the disposal of equipment; — Section 5(2)

(c) excluded expenditure; — Section 5(4)

(d) expenditure not at arm's length. — Section 5(5)

III.10 Where allowable expenditure gives rise to a receipt or a deemed receipt (except for sale of licence rights), that expenditure is to be reduced by the amount of the receipt. If received in a subsequent period, the receipt is to be treated as a positive amount. Where test production oil is disposed of otherwise than at arm's length, or is appropriated, the oil is deemed to be disposed of for market value.

Section 5(6)
Section 5A(5)
Para. 12 Sch. 8 FA 83
Section 5A(5B)

III.11 A company may, in certain circumstances, claim expenditure incurred by a company associated with it, but the relief is closely controlled in order to prevent companies obtaining relief by artificial arrangements.

III.12 A company which is a participator is treated as associated with another company if the two companies fulfil either of the following conditions throughout that part of a period, known as the relevant period, in which they were both in existence:

Section 5(7)&(8)

(a) one is a 51 percent subsidiary of the other (and the other is not a 51 percent subsidiary of any other company);

(b) both are 51 percent subsidiaries of a third company which is not itself a subsidiary of any other company.

Section 1154 CTA 10 applies to define 51 percent subsidiary. The relevant period is the period beginning immediately before the expenditure was incurred by the other company and ending with the later of:

(a) the end of the earliest chargeable period in which the company became a participator in the field;

(b) the end of the chargeable period in which the expenditure was incurred.

Abortive exploration expenditure

Sections 2(9)(d) & 5
Section 237 FA 94
Section 113 FA 84

III.13 The abortive exploration expenditure which may be claimed is any expenditure incurred by a participator on or after 1 January 1960 and before 16 March 1983 which satisfied all of the following conditions:

(a) it was incurred by the claimant or, if the claimant is a company, by a company associated with it in respect of the expenditure;

(b) it was incurred wholly and exclusively for the purposes of searching for oil in the UK or the designated areas;

(c) it is not and is unlikely to become allowable as field expenditure.

For this purpose, expenditure is deemed to be allowable as field expenditure if it would be allowable but for the fact that the field in question is a non-taxable field. This relief is not available against any field in which the company became a participator after the end of that field's first chargeable period and after 13 September 1983, if the expenditure was incurred before the company became a participator in that field.

III.14 The effect of the provisions outlined in Paragraphs III.1 and III.13 is that no relief is available for onshore UK exploration expenditure incurred after 31 March 1986 under either the E&A expenditure rules or the abortive exploration expenditure rules.

III.15 No relief is available under these provisions for licence premiums paid to the Secretary of State in respect of surrendered acreage, until it can be shown that they are unlikely to become allowable in the normal way for any taxable field which may be determined within the licensed area. HMRC also adopts a restrictive interpretation of the meaning of 'unlikely to become allowable': it looks in practice for a high degree of probability that the expenditure will not become allowable in the normal way. No part of any abortive exploration expenditure qualifies for uplift. Other detailed conditions are similar to those in Paragraphs III.9-III.12 above.

Appendix IV

Transfer pricing

IV.1 Following the introduction of the corporation tax self-assessment regime, the transfer pricing rules were overhauled and strengthened. These rules apply for accounting periods and tax years ending after 30 June 1999. The legislation has been drafted to follow the OECD's guidelines, and Article 9 of the OECD Model Tax Convention on Income and on Capital.

Section 164
TIPOA 10

The basic rule

IV.2 Broadly, the transfer pricing rules apply to transactions between related companies. If such transactions do not occur on an arm's length basis and a UK tax advantage arises, a company is required to make the appropriate adjustments to the profits or losses in its corporation tax return. Before 1 April 2004 the transfer pricing rules largely applied only to cross border transactions. However, UK to UK transactions are now also caught by the transfer pricing legislation.

Section 147
TIPOA 10

Special provision for companies carrying on ring fence trades

IV.3 The full transfer pricing legislation now applies to cross ring fence transactions. Previously transactions across the ring fence (including within a single company) were subject to arm's length rules. The new transfer pricing rules include cross ring fence transactions within a single company and assume that the ring fence trade and the non-ring fence activity are carried on by two different people.

Section 205
TIPOA 10

IV.4 Transfer pricing adjustments to cross ring fence transactions can only be made where the substitution of an arm's length price would increase the ring fence profits (i.e., it cannot be invoked to reduce a company's ring fence profits for tax purposes).

Section 174
TIPOA 10

Where a transfer pricing adjustment as explained above, occurs and the other party is a UK company, that other company may claim a corresponding adjustment. The transfer pricing rules in Sch 28AA will be overridden where transactions are subject to Section 280 CTA 10, which determines how oil disposed of or appropriated in certain circumstances should be valued for tax purposes.

Advance Pricing Agreements (APAs)

IV.5 APAs can be entered into with HMRC. HMRC will only consider APA requests where the issues involved are 'complex', i.e., where there is considerable difficulty in determining how the arm's length principle should be implemented. An APA can be unilateral, bilateral or multilateral depending on the number of tax authorities involved in the process. HMRC recommends bilateral/multilateral APAs in order to avoid potential exposure to double taxation and to achieve assurance from all tax authorities involved. An APA normally lasts for between three and five years.

IV.6 The taxpayer will usually be required to prepare and retain an annual compliance report to demonstrate compliance with the terms and conditions of the APA. Failure to provide annual reports can lead to a penalty. Tax geared penalties also apply where a return is made in connection with an APA which contains false or misleading information. An additional penalty of £10,000 can be imposed in such circumstances.

HMRC guidance on documentation

IV.7 The transfer pricing provisions require taxpayers to maintain suitable records and evidence to demonstrate that the arm's length principle has been applied, where relevant.

HMRC issued guidance on documentation requirements in Issue 37 of its Tax Bulletin and this has been superseded by the guidance contained in HMRC's manuals (INTM 433030). The guidance states that there are 4 classes of records/evidence that should be considered, including the primary accounting records. The guidance also indicates when the supporting documentation should be generated and what type of documentation is required to demonstrate an arm's length result.

Companies are not required to prepare additional documentation provided the existing documentation is sufficient to enable the company to make a complete return under Corporate Tax Self Assessment. Documentation should exist at the time that a tax return is made and should be retained for six years or, where an HMRC enquiry is ongoing at that six-year date, until the end of that enquiry.

Penalties

IV.8 As companies are required to complete the self assessment corporation tax returns on the basis that the prices are arm's length, penalties can be charged where:

Sch 55 FA 2009

- a return is made which is not in accordance with the arm's length principle;
- it can be shown that the return was submitted fraudulently or negligently by the taxpayer; and
- UK tax is lost as a result.

The maximum penalty that may be charged is equal to the tax lost by reason of the offence. In negotiated settlements the penalty will be abated to an appropriate percentage of the culpable tax.

VI.9 In guidance contained in issue 38 of HMRC's Tax Bulletin and in HMRC's manuals (INTM 433030), HMRC acknowledges that arm's length pricing is a matter of judgement and there is not always one 'right' answer. HMRC's guidance advises that where taxpayers show that they have made an honest and reasonable attempt to comply with the legislation, there will be no penalty even if there is an adjustment. They also advise that there is an obligation on taxpayers to do what a reasonable person would do to ensure that their returns are made in accordance with the arm's length principle. This involves but is not limited to:

- using their commercial knowledge and judgment to make arrangements and set prices which conform to the arm's length standard (or make computational adjustments in their returns where they do not);
- being able to show (for example, by means of good quality documentation) that they made an honest and reasonable attempt to comply with the arm's length standard and with the legislation; and
- seeking professional help where they know they need it.

In addition to the tax-geared penalties referred to above, penalties of up to £3,000 can be charged for failure to keep proper records.

Temporary relaxation of penalties

IV.10 There was a temporary relaxation of penalties in respect of 'insufficient' record keeping for accounting periods beginning on or after 1 January 2004 and ending on or before 31 March 2006. This relaxation does not extend to the

s33(3) FA 2004

penalties imposed for failing to apply the arm's length test. In respect of the £3,000 penalties mentioned above, there was a full relaxation. FA 2004 section 33(3) disapplies this penalty if the records that the company in question fails to keep are 'records relating to an arm's length provision'. The relaxation is limited in respect of tax-geared negligence penalties. The extent of the relaxation is if a taxpayer is regarded as having been negligent only by failing to preserve adequate documentation. It is unlikely that an analysis would have taken place without the necessary documentation being produced, so that a written record being optional is arguably an insignificant concession.

Appendix V

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Appendix VI

Countries in which KPMG's global network of firms operate

Africa

Algeria
Angola
Botswana
Ghana
Kenya
Malawi
Mauritius
Morocco
Mozambique
Nigeria
Senegal
Sierra Leone
South Africa
Swaziland
Tanzania (United Republic of)
Tunisia
Uganda
Zambia
Zimbabwe

Asia/Pacific and Australasia

Afghanistan
Armenia
Australia
Azerbaijan
Bangladesh

Brunei Darussalam
Cambodia
China
Cook Islands
Fiji
French Polynesia
India
Indonesia
Japan
Kazakhstan
Korea (Republic of)
Kyrgyzstan
Laos (People's Democratic Republic)
Macau
Malaysia
Maldives
New Caledonia
New Zealand
Pakistan
Papua New Guinea
Philippines
Singapore
Sri Lanka
Taiwan (Province of China)
Thailand
Uzbekistan
Vietnam

Europe

Albania
Andorra
Austria
Belarus
Belgium
Bosnia & Herzegovina
Bulgaria
Croatia
Cyprus

Czech Republic
Denmark
Estonia
Finland
France
Georgia
Germany
Gibraltar
Greece
Hungary
Iceland
Ireland
Italy
Latvia
Liechtenstein
Lithuania
Luxembourg
Macedonia (the former Yugoslav Republic of)
Malta
Moldova (Republic of)
Netherlands
Norway
Poland
Portugal
Romania
Russian Federation
Serbia Montenegro
Slovakia
Slovenia
Spain
Sweden
Switzerland
Turkey
Ukraine

Central and South America

Argentina
Brazil
Chile
Colombia
Costa Rica
Ecuador
El Salvador
Guatemala
Honduras
Mexico
Nicaragua
Panama
Peru
St Vincent & The Grenadines
Uruguay
Venezuela

Middle East

Bahrain
Egypt
Iraq
Israel
Jordan
Kuwait
Lebanon
Oman
Qatar
Saudi Arabia
United Arab Emirates
Yemen

North America and Caribbean

Anguilla
Antigua & Barbuda
Bahamas
Barbados
Canada

Cayman Islands
Dominican Republic
Jamaica
Puerto Rico
St Lucia
Trinidad & Tobago
Turks & Caicos Islands
United States & Americas
Virgin Islands (British)
Montserrat
Saint Kitts and Nevis

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